
CHAPTER: Examination Administration

SECTION: Using the Handbook

Section 010

Introduction

The trust and asset management handbook is designed to assist examiners in planning and conducting examinations of trust and asset management products and services provided by a savings association to its customers. The handbook is also designed to aide in fulfilling OTS's responsibilities to ensure that trust and asset management activities of savings associations are conducted in a manner that determines and ensures that trust powers are exercised in a manner consistent with applicable law and OTS policies. OTS examiners carefully evaluate the capability of management, the soundness of policies and practices, the quality of service rendered to the public and the effect the offering of trust and asset management products and services has on the soundness of the institution.

In addition to containing examination and supervisory policies and procedures, the handbook includes an overview of trust and asset management products and services that can be provided by a savings association, a discussion of the component rating categories under the Uniform Interagency Trust Rating System and standards of fiduciary conduct that are applicable to a savings association.

Objectives

The objectives of the trust and asset management handbook are to provide a clear statement of OTS examination policies, standards and procedures; to promote the consistent application of those policies, standards and procedures; and to enhance the quality and effectiveness of trust and asset management examinations. The handbook can be used as a guide to OTS policy and procedure, as a reference tool and as a training aide.

Through the examination process, regulatory personnel evaluate trust and asset management activities to identify those institutions requiring special supervisory attention. The first section of the handbook contains a more detailed description of trust and asset management examination objectives. The results of the examination are highlighted in a written report and distributed by the regional offices to the board of directors of an institution. The examination report points out the strengths and weaknesses of an institution and seeks the correction of any cited violations or operational flaws.

The reader's education, experience, and judgment should supplement the use of the handbook. Updates and revisions to the handbook may be published and distributed periodically. Separate handbooks are also available covering Thrift Activities, Compliance Activities, Holding Companies, FFIEC Information Systems Examination and Application Processing.

Handbook Organization: Chapters and Sections

The handbook utilizes a topic heading system for identification, organization and referencing and is organized into six chapters. Within each chapter, materials are organized by subject matter into sections, each with its own set of identifying numbers, generally based on increments of 10. To illustrate, the first chapter is titled "000 Examination Administration," and the first section is titled "010 Using the Handbook."

The first chapter, sections 010 through 130, covers the basics of the trust and asset management examination process and provides additional resources for the examiner to use. Chapters 200 through 880 parallel the subject areas contained in the revised Uniform Interagency Trust Rating System. Each of these chapters

contains introductions and related examination programs. The introductions provide background material and guidance, while the examination program provides information regarding examination procedures.

Examination Programs Section

The examination programs highlight the objectives and examination procedures by subject matter. These sections contain several subsections: 1) examination objectives; 2) examination procedures; 3) final risk assessment; 4) overall risk assessment; 5) examiner's UITRS rating, summary, conclusions and recommendations; 6) references; and 7) workpaper attachments. Each of these subsections is described more fully below.

Examination Objectives: Examination objectives identify the goal the examiner is striving toward in conducting a review of the subject area. Identification of the objectives will assist in determining the scope of the examination for a specific area of interest and may also be germane to the overall examination process.

Examination Procedures: The examination procedures are organized in a top-down fashion and are divided into three groups, each representing a different level or depth of exam based on a risk assessment. The three groups are Levels I, II and III. With this approach, trust and asset management examiners can expeditiously assess the degree of risk in each area of a particular savings association's operations early in the examination and determine the depth of exam (Levels I, II or III) that will be needed in order to determine whether examination objectives have been met.

Final Risk Assessment: A final risk assessment for each examination procedure with respect to the examination objectives should be determined, based on the level of examination conducted. The final risk assessment is in the form of a matrix with the five types of risk being assessed against a determination of the quantity of risk (high, medium or low), the quality of controls (effective, acceptable or weak) and the direction of risk (increasing, decreasing or stable).

Overall Risk Assessment: An examiner will support the ratings given in the matrix with a concise summary explanation for each of the risk categories as to quantity, quality and direction of risk.

Examiner's UITRS Rating, Summary, Conclusion and Recommendation: The examiner should conclude each examination program with a detailed summary of findings, conclusions, and, if applicable, recommendations.

References: Pertinent legislative and regulatory citations are included throughout the narrative sections of the handbook. These references include federal laws and regulations applicable to the savings association as a corporate entity (e.g., OTS regulations relating to the exercise of fiduciary powers); federal laws and regulations applicable to specific types of activity that the department may have (e.g., provisions of the federal securities laws, the Internal Revenue Code and ERISA); recognized source materials (e.g., the AICPA's Audit Guide and The Investment Advisory Act of 1940); and references to other relevant OTS issuances such as Thrift and Regulatory Bulletins. Users of the handbook are cautioned to consult applicable state laws, which are not specifically referenced or included.

Workpaper Attachments: Examiners should identify all documents and workpapers supporting their conclusions in this section. Workpapers should be filed behind the examination program and indexed in sequential order.

Description of Items in Table of Contents

000 – General

This chapter covers the basics of the trust and asset management examination process as detailed in the sections below.

Section 010	<i>Using the Handbook:</i> Describes the objectives and organizational structure of the handbook.
Section 020	<i>Examination Programs for Trust and Asset Management Activities:</i> Provides a summary of the significant features of the trust and asset management examination program.
Section 030	<i>Supervision by Risk:</i> Describes the philosophy and methods used by the OTS to supervise the trust and asset management activities of OTS regulated institutions. It introduces the “top-down” and risk-focused approach as it applies to trust and asset management examinations; discusses that approach in relation to the examination; and discusses off-sight monitoring between examinations.
Section 040	<i>Examination Planning and Control:</i> Covers the different types of trust and asset management examinations; discusses the preexamination planning process; provides guidelines for establishing the scope of an examination; and, provides guidelines for reaching conclusions and discussing examination findings with management.
Section 041	<i>PERK:</i> Description of the Pre-Examination Response Kit (PERK). It identifies the examiner’s information request that is delivered to the savings association prior to the start of an examination. It is not an all-inclusive list but does detail much of the information needed during an examination.
Section 042	<i>Useful Reports:</i> Listing of common reports generated by most trust department automated systems that may be used in connection with the trust and asset management examination.
Section 050	<i>Report Preparation and Issuance:</i> Contains a summary of the instructions for preparing and issuing a trust and asset management examination report.
Section 060	<i>Assignment of Ratings:</i> Contains a discussion of the Uniform Interagency Trust Rating System that is used to assign individual and composite ratings to a trust department.
Section 070	<i>Post Examination Activities:</i> Covers the transmittal of the report of examination to the affected institution, meetings with the board of directors and follow-up monitoring activities.
Section 080	<i>Enforcement Actions:</i> Addresses the formal and informal enforcement tools used by OTS to carry out its supervisory responsibilities.
Section 090	<i>Trust and Asset Management Trust-Only Examinations:</i> Covers the procedures to be followed for the examinations of OTS regulated savings associations and their holding companies when the institution engages only in trust and asset management activity. These institutions are considered “special purpose” because they do not perform commercial or retail banking services by granting credit or taking deposits from the public in the ordinary course of business.

100 – Overview

This chapter presents an overview of trust and asset management activities, provides more detail regarding fiduciary duties, risks & liabilities and discusses applicable law and the trust powers of savings associations.

- Section 100** *Trust and Asset Management Activities:* Describes the typical services offered by a trust department, the reasons for establishing a trust and the objectives of OTS trust and asset management regulation.
- Section 110** *Fiduciary Duties, Risks and Liabilities:* Addresses the duties and responsibilities of a fiduciary to its customers, risks associated with the exercise of trust powers and the risk management steps each institution should take to manage fiduciary risk.
- Section 120** *Applicable Law:* Provides a summary of federal laws and regulations applicable to OTS institutions exercising trust powers.
- Section 130** *Trust Powers:* Summarizes the process for applying to the OTS for the exercise of trust powers, the criteria used in granting powers and the revocation or surrender of trust powers.

200 – Management

Addresses the overall capabilities of the board of directors and management in their respective roles, to identify, measure, monitor and control the risks of a savings association's trust and asset management activities.

- Section 200** *Introduction to Management:* Discusses management, board oversight and the organizational structure of a trust department.
- Section 210** *Management Appraisal (Narrative and Examination Program):* The narrative discusses the elements necessary to evaluate the savings association's management structure. The examination program will enable examiners to evaluate the effectiveness of the organizational structure and director supervision; performance, capabilities and adequacy in number of officers and staff; adequacy of committee minutes; responsiveness to audit and examination reports; adequacy of business plans; review of financial performance; use of legal counsel; and sufficiency of insurance coverage.
- Section 220** *Risk Management (Narrative and Examination Program):* Contains a discussion on risk management and the risk assessment process which management should implement as part of its internal controls. The examination program will enable examiners to evaluate the effectiveness of an institution's risk management responsibilities.

300 - Operations, Internal Controls, and Audit & Information Technology

Discusses the operations area that can be characterized as consisting of three primary functions: 1) its system of accounting and records; 2) its system of providing for the custody and control over trust account assets; and 3) its system of processing transactions in those assets. Even when operational functions have been outsourced, a savings association should have strong oversight over these functions and establish proper internal controls.

- Section 300** *Operations, Internal Controls, Audit & Information Technology:* Topics include: trust accounting principles; the adequacy of accounting systems and records including cash and asset ledgers; account balances, reconcilements, and suspense accounts; and records relating to the principal and income of trust accounts. Also, the effectiveness of internal controls and safeguards, including those relating to joint custody, dual control, vault procedures; pledge requirements and assets held off-premises; and the effectiveness of systems and controls over the processing of assets, including security movement and control systems; pending transactions; trading activities; and receipts and disbursements. Addresses the adequacy of records and controls over specific activities or functions, including cash management, overdrafts, consumer lending and securities lending.
- Section 310** *Operations and Internal Controls Examination Program:* Provides examiners with a program for evaluating the effectiveness of the savings association's operations and internal controls.
- Section 400** *Introduction to Audits:* Provides examiners with information necessary to evaluate the effectiveness of the savings association's audit procedures.
- Section 410** *Audit Examination Program:* Provides examiners with a program for evaluating the effectiveness of the savings association's audit procedures.
- Section 500** *Introduction to Information Technology:* Provides examiners with information that will help them evaluate management's procedures for identifying and controlling the level of risk within information technology.
- Section 510** *Information Technology Examination Program:* Provides examiners with a program evaluating management's procedures for identifying and controlling the level of risk within information technology.

600 – Earnings

Addresses the trust department's operating results and earnings trends and the probable effect on the profitability of anticipated future business.

- Section 600** *Introduction to Earnings:* Contains a discussion on the analysis and evaluation of present and past financial results, fee schedules and the effect of losses. Addresses management's responsibility to establish effective marketing plans and realistic budgets as well as measure present and project future profitability.
- Section 610** *Earnings Examination Program:* Provides examiners with a program for evaluating the impact that the trust department's financial results have on the savings association.

700 - Compliance

This chapter encompasses the trust department's policies, practices and procedures relating to its compliance with applicable law and OTS fiduciary standards. It also contains a description of the various business lines that may be found in a trust department and discusses the various conflicts as well as the applicable legal principles associated with the various business lines.

- Section 700** ***Introduction to Compliance:*** Discusses a trust department's account administrative procedures which includes: soundness of and compliance with policies and procedures; acceptance and termination of accounts; use of synoptic sheets and tickler systems; timeliness of administrative actions; account review process; compliance with applicable law; and conformity with account instruments and account objectives. It contains a discussion on various accounts not described in the individual examination program narratives.
- Section 710** ***Introduction to Conflicts of Interest & Examination Program:*** Provides examiners with information and a program to enable them to evaluate management's procedures for safeguarding against conflicts of interest.
- Section 720** ***Introduction to Personal and Court Accounts & Examination Program:*** Provides examiners with information and a program to enable them to evaluate management's procedures for administering personal and court accounts.
- Section 730** ***Introduction to Employee Benefit Accounts & Examination Program:*** Provides examiners with information and a program to enable them to evaluate management's procedures for administering employee benefit accounts.
- Section 740** ***Introduction to Private Banking & Examination Program:*** Provides examiners with information and a program to enable them to evaluate management's procedures for administering private banking and wealth management services.
- Section 750** ***Introduction to Corporate Trust & Examination Program:*** Provides examiners with information and a program to enable them to evaluate management's procedures for administering corporate trusts.

800 – Asset Management

This chapter encompasses policies, practices and procedures relating to the selection, retention and preservation of trust assets. It includes a review of the savings association's methods or processes related to the investment of all discretionary accounts.

- Section 800** ***Introduction to Asset Management:*** Discusses the investment constraints of a fiduciary, including the prudent person and investor rules and conformity with investment provisions of governing account instruments; investment policy, including the board of directors' responsibilities; and the adequacy of the investment selection and retention process, including the needs and objectives of accounts; review of asset holdings; and sufficiency of supporting documentation.

- Section 810** *Introduction to Portfolio Management & Examination Program:* Provides examiners with information and a program to enable them to evaluate management's process over the selection of investments for a particular account.
- Section 820** *Introduction to Marketable Securities & Examination Program:* Provides examiners with information and a program to enable them to evaluate a trust department's selection of marketable securities.
- Section 830** *Introduction to Mutual Funds & Examination Program:* Provides examiners with information and a program to enable them to evaluate a trust department's selection of mutual funds.
- Section 840** *Introduction to Closely-Held Business Interests & Examination Program:* Provides examiners with information and a program to enable them to evaluate a trust department's procedures for managing an account's closely held business interests.
- Section 850** *Introduction to Real Estate Interests & Examination Program:* Provides examiners with information and a program to enable them to evaluate a trust department's management of real estate interests held as assets of an account.
- Section 860** *Introduction to Miscellaneous Assets & Examination Program:* Provides examiners with information and a program to enable them to evaluate a trust department's management of miscellaneous assets held in accounts.
- Section 870** *Introduction to Insurance Products & Examination Program:* Provides examiners with information and a program to enable them to evaluate a trust department's procedures for managing insurance products.
- Section 880** *Introduction to Common and Collective Investment Funds & Examination Program:* Provides examiners with information and a program to enable them to evaluate a trust department's procedures for the management of any common and/or collective investment funds it administers.

Trust & Asset Management Glossary

CHAPTER: Examination Administration

SECTION: Examination Programs for Trust And Asset Management

Section 020

Introduction

The Office of Thrift Supervision established a specialized examination program for trust and asset management activities in January 1989. Examinations for these activities are conducted by a specialized, dedicated, career-professional examination force. The significant features of this program are discussed below. This program reinforces the importance that OTS places on the trust and asset management area as well as strengthens the overall approach to examination and supervision of savings associations.

Significant Features of the Specialized Program

The significant features of the examination program are:

- Specialized trust and asset management examinations are conducted using the “Supervision by Risk” examination approach (see Section 030).
- Specially trained examination personnel conduct separate examinations for trust and asset management activities.
- Separate reports of examination are presented to an institution’s board of directors.
- OTS uses the Uniform Interagency Trust Rating System to evaluate an institution’s trust and asset management activities. This rating system is also used by the other federal regulatory agencies.

Handbook

This trust and asset management activities handbook, which is part of the regulatory handbook series, reflects the principles and procedures of the specialized examination program. It is designed to assist examiners in planning and conducting examinations of trust and asset management activities provided by an OTS regulated institution to its customers. The handbook is also designed to aide in fulfilling the OTS’s responsibilities to ensure that trust and asset management activities of supervised institutions are conducted in a manner that determines and ensures that trust powers are exercised in a manner consistent with current laws, regulations and OTS policies.

Training

OTS has a staff of specialists to conduct trust and asset management examinations. Examination personnel involved in the specialized program receive training regarding trust and asset management activities and examination approach and philosophy.

Examination Coverage

Specialized trust and asset management examinations are conducted using a “top-down, risk-focused” examination approach. This approach shifts the examination focus away from individual transactions to a review of internal policies, procedures and compliance programs. The approach also focuses on the areas of greatest risk, as outlined in Section 030, Supervision by Risk. This approach may be supplemented by an evaluation of the integrity of these internal programs through periodic testing and general examination oversight.

Reports of Examination

A separate report to an institution's board of directors is prepared for examinations conducted under this specialized program. The report details examination findings in a narrative format that gives the reader a thorough analysis of the integrity of the institution's management oversight; systems and controls; and its strengths and weaknesses. Only examiners that have received accreditation in the OTS accreditation program may lead the trust and asset management exam and sign the examination report.

Ratings

The Uniform Interagency Trust Rating system, which the OTS uses, assigns an overall rating to the trust and asset management area and a rating for each of the five component subjects. The rating system uses a five point grading scale with "1" representing the best rating and "5" the poorest.

Examination Frequency

The frequency of examinations is primarily dependent upon the rating assigned at the previous examination. The lower the rating, the more frequently the institution is to be examined, thus assuring that examination resources are directed to those institutions that are in most need of examination and supervisory attention. Examinations under this specialized program are generally conducted separately but can be conducted concurrently with safety and soundness or compliance examinations when practicable.

Background

This section describes the philosophy and methods used by the Office of Thrift Supervision to supervise the trust and asset management activities of OTS regulated savings associations. The supervisory process must be as dynamic as the industry itself. The process should evaluate the savings association's ability to proactively identify, measure, monitor and control the risks inherent within the trust and asset management business. The supervisory process should also ensure adherence to the basic fiduciary concepts of prudent account administration, investment management and the duty of undivided loyalty.

The trust and asset management industry has experienced many changes in both the nature and complexity of these activities. The industry has become growth oriented and highly competitive. It has also been impacted by demographic, technological, regulatory and global economic trends in the past quarter century. Notable characteristics of the industry's evolution include:

- fee income becoming a significant contributor to a financial institution's profits;
- industry consolidation through mergers and acquisitions;
- competition from all financial service providers such as banks, investment companies, insurance companies and brokerage firms;
- shift from defined benefit plans to defined contribution plans and IRA's;
- development of complex and rapidly changing products, services and delivery technologies; and
- increased sophistication and litigation tendencies of the customer base.

Terminology used within the industry has changed considerably. Many years ago the use of the term "the trust business" denoted instances in which a bank or savings association was acting as a fiduciary. Today, a reference to the trust business increasingly signifies an institution providing trust and asset management services. The term "asset management" is used by the industry and throughout this handbook to mean the management of third-party assets for a fee or commission. Trust and asset management thus includes the provision of fiduciary services (personal, employee benefit, corporate and investment advisory services) as well as agency arrangements including custody of assets. All these trust and asset management services are provided through various distribution channels that depend upon the size, complexity and geographic characteristics of the trust department. For ease of reference, the term "trust department" is used in this handbook to refer to trust and asset management activities conducted within the savings association, a service corporation, an affiliate or an operating subsidiary.

As a result of the many changes in the industry, institutions are exposed to broader and evolving risks, which reinforce the importance of maintaining sound risk management processes. The OTS will continue to emphasize the importance for savings associations to identify, measure, monitor and control all risks associated with their trust and asset management activities. Strong risk controls and monitoring systems are essential to ensure effective management of risk exposures across all geographies, legal entities, products and services.

Introduction

The trust and asset management business presents varied and unique risks to a savings association and therefore warrants a risk oriented supervisory approach. Under this approach examiners do not attempt to prohibit risk taking, but rather, attempt to ensure that the management and directors of the savings association understand and control the levels and types of risk they assume. As an organization grows more diverse and complex, risk management must keep pace. When risk is not properly managed, the OTS examination process will direct management to take corrective action.

The supervision by risk concept is a “top-down” approach that focuses on the process and methodology used by the trust department to identify, measure, monitor and control risks. This concept allocates greater resources to those areas with higher risks. The supervision by risk concept is achieved by using common definitions to identify risk, common methods of evaluation to measure risk and an overall evaluation of risk management to determine whether systems adequately manage and control existing levels of risk. The objectives of the supervision by risk concept are to:

- determine the condition of the savings association’s trust and asset management activities and the risks associated with current and proposed activities, including risks originating in operating subsidiaries, service corporations and affiliates.
- determine whether management has effectively identified risks within its trust and asset management activities.
- evaluate the overall integrity and effectiveness of risk management systems, using periodic validation techniques to verify accuracy.
- ensure adherence to applicable law and sound fiduciary principles.
- communicate findings, recommendations and requirements to directors and senior management in a clear and timely manner and obtain commitments to correct significant deficiencies.
- verify the effectiveness of corrective actions or if actions have not been satisfactorily accomplished, pursue resolution through more aggressive supervision or enforcement actions.
- pursue continuous off-sight monitoring to assess the impact of internal and external changes on the trust department.

A properly executed supervision by risk concept results in a risk-focused examination methodology that will generate a risk profile for each savings association; cause a review of the risk identification, measurement, monitoring and control processes used by the savings association; ensure compliance with applicable law and sound fiduciary principals; and utilize resources effectively.

Concept and Components

The success of the supervision by risk concept will require the examiner to have comprehensive knowledge of the specific savings association and the overall industry. Since the scope of any supervisory activity will be determined based upon an assessment of risks, the examiner should have current and thorough information regarding the trust and asset management activities of the savings association. Such information can be gathered through review of prior examination reports and workpapers; strategic plans and budgets; internal management reports; board of directors packages; meeting minutes; press releases; published news stories; and discussions with trust department personnel.

The examiner should also determine the quantity of risk present and assess the quality of risk management. This practice is also utilized for determining the scope of examination (level I, II or III) in the trust and asset management examination process as detailed in the individual examination programs of this handbook. A well-executed internal risk management system (including a strong audit and compliance function) would likely reduce the examination level in the examination process.

There are various types of risk inherent in each trust and asset management activity, broadly identified as: reputation; strategic; transaction/operational; compliance/legal; and financial risk. These risks are therefore present in each savings association engaged in trust and asset management activities. After a determination as to the types and quantity of risk present, the examiner should assess the savings association's process for identifying, measuring, monitoring and controlling such risks. When assessing the quality of risk management, the examiner should consider board and senior management oversight; policies, procedures and practices; management information systems and controls; and audit, compliance and risk management functions. Factors to consider and address include:

- Quantity of risk: (High, Medium, Low)
- Quality of risk management: (Effective, Acceptable, Weak)
- Direction of risk: (Increasing, Stable, Decreasing)

Once the overall integrity of the savings association's oversight system is verified, conclusions as to the quantity and direction of risk may be made based upon the institution's own assessment of those risks rather than the need for the examiner to perform extensive transaction testing. If on the other hand, the savings association's process appears to be inadequate or nonexistent, transaction testing may be necessary.

Risk Definitions

The definition of risk associated with trust and asset management activities will be a compilation of the many risks associated with the business. These risks are outlined below. Although each risk will be reviewed individually, they are all interrelated and therefore need to be viewed as such.

Reputation Risk: This is the risk to the savings association's earnings and capital arising from negative public opinion. Negative publicity (often the result of lawsuits) can be caused by many factors, including failure to address and manage the other risks identified below. Increased reputation risk can affect the savings association's ability to establish appropriate customer relationships and/or service existing relationships. Failure to properly monitor all risks will subject the savings association to litigation and financial loss.

Strategic Risk: This is the risk to the savings association's earnings and capital arising from improper business planning; poor decision-making and failure to implement decisions; or inadequate responses to changes in the industry. This risk focuses on the savings association's ability to develop sound business strategic goals and deploy appropriate resources to achieve them. The savings association's strategy should be developed using an analysis focusing on its strengths, weaknesses and opportunities.

Transaction/Operational Risk: This is the risk to the savings association's earnings and capital arising from the inability to perform certain agreed upon functions in the delivery of a trust product or service, as well as the oversight of information and technology. Transaction risk is evident in each product and service offered.

Compliance/Legal Risk: This is the risk to the savings association's earnings and capital arising from noncompliance with applicable law and sound fiduciary principles, internal policies and procedures or ethical standards. This risk exposes the savings association to potentially increased legal costs, fines, civil money penalties and surcharges. More importantly however, the savings association's reputation is also negatively impacted, thereby affecting franchise value and increased business opportunities.

Financial Risks: There are several subsets of financial risk that are inherent in fiduciary activities where the financial institution has discretion over account assets or provides investment advisory services for a fee. Each individual discretionary account may present one or more of the subsets of financial risk.

- *Credit Risk:* This is the risk to the value of the fiduciary account portfolio arising from an obligor's failure to meet the terms of any contract. Credit risk is found in all activities where success depends on the counterparty, issuer of a security or borrower of funds. (Example: Fiduciary decides to invest in a corporate fixed income obligation in order to generate income for account. The issuer/obligor fails to pay interest and/or principal, creating a default. The income generation objective of the account has been violated by the inability of the obligor to pay. This account was adversely impacted by credit risk).
- *Price Risk:* This is the risk to the value of the fiduciary account portfolio arising from changes in the market value of traded financial instruments.
- *Liquidity Risk:* This is the risk to the value of the fiduciary account portfolio arising from the account's inability to meet obligations and achieve account objectives. Liquidity risk includes the inability to manage unplanned decreases in account assets. (Example: Fiduciary decides to purchase securities for account portfolio that for some reason decline in value or are limited in marketability. Account objectives require that adequate liquidity be maintained to achieve a stated goal, such as generating income. Due to the lack of liquidity in account assets, a stated account objective may not be achieved or the value of the account may be negatively impacted).
- *Interest Rate Risk:* This is the risk to the value of the fiduciary account portfolio arising from movements in interest rates. (Example: Fiduciary decides to invest in a corporate fixed income obligation in order to generate income for the account. The decision to purchase such a security was based upon the current interest rate environment and the yield being provided by the investment. Due to an increase in interest rates, the yield on the account investment decreases. This account is then adversely impacted by interest rate risk).
- *Foreign Exchange Risk:* This is the risk that movements in exchange rates may adversely affect the value of a fiduciary account's holdings. Since foreign-exchange rates can be subject to large and sudden swings, strong management expertise is needed to understand and manage the risk associated with exchange-rate volatility.

The earnings and capital of savings associations with significant reliance on trust and asset management revenues may be adversely affected when financial markets experience a significant and sustained downturn. Since trust departments are dependent on transaction volumes and market values of assets under management; revenue and hence earnings, may decline substantially during periods of adverse market movements. Savings associations could ultimately find themselves funding trust department capital when unfavorable market conditions exist.

Supervision Process

Supervision by risk is a dynamic process and involves four basic areas.

Planning: Planning begins with a careful and thorough assessment of the savings association's current and anticipated risks. Effective and periodic communication with management is also necessary in this process. Supervisory strategies must be developed prior to any activity and should incorporate the information known about the savings association as well as industry, economic, legislative and regulatory developments. Supervisory strategies direct examination priorities.

Examining: The on-sight examination assesses the savings association's condition, establishes correction of significant deficiencies and identifies activities to be monitored off-sight. Through a formal examination, examiners gain a fundamental understanding of the condition of the trust department, the quality of management and control provided by risk management systems. When possible, examiners should rely on the savings association's internal systems, including its internal and external audits, compliance functions and risk management systems. These systems may need to be periodically tested and validated for integrity and reliability. The examiner conducts the review by following examination programs that include: management, operations, controls and audits, earnings, compliance and asset administration (MOECA).

Sampling/Testing: Historically, choosing a representative sample of trust accounts, assets or activities to be reviewed during an examination has been one of the first things on the examiner's agenda. For example, in the past, samples have been chosen before ever talking with management; looking at the savings association's policies, procedures and controls; or reviewing audit reports. Likewise, the sampled items have often been reviewed in detail even though past examinations and recent audit reports indicated no concerns; excellent controls; established safeguards and management; and staff remain qualified and stable. In the risk focused examination process, a distinction is drawn between exception based sampling and the risk focused selection of a few accounts or assets merely to verify that policies or procedures are working as reported; to clarify a policy or process; or to actually see how a particular situation is handled. The basic premise of the risk focused examination is that sampling is done **"as necessary"**, not automatically.

This is not to say that at any time during the examination process the examiner cannot look at a couple of accounts, assets or an activity in order to get a better feel for a process; better understand the implementation of a new policy or product; or confirm an assertion made by management or the auditors. That would not be unusual during any examination but the review should be limited in scope and directed to a specific question or situation.

Sampling and testing of accounts, assets and activities has a place in, and remains an integral part of, the examination process, however it is used in a little different context in the risk focused examination world. The automatic starting point for each examination should not be sampling and testing.

Communication: Off-sight monitoring and onsite trust and asset management examinations are discussed with and reported to senior management and the board of directors. Corrective action is recommended and a monitoring process is implemented to ensure management is establishing appropriate controls in the risk management system.

The supervision by risk process is continuous. Onsite examinations simply supplement the process. Monitoring includes periodic communication with the management of the trust department, as well as reviewing financial and account information submitted to OTS. Identification of higher risk areas within an savings association, which can also be affected by the external (e.g., economic) environment should

determine the level of oversight between examinations, the frequency of onsite examinations and the level of onsite examinations.

As a general rule:

Associations rated “1” would receive alternating regular and targeted examinations at 24 month intervals.

Associations rated “2” would receive a regular examination on a 24 month interval.

Associations rated “3” and “4” should receive a regular examination on a 12 month interval.

Associations rated “5” should receive a regular examination on at least a 6 month interval.

Associations with trust assets totaling more than \$1 billion should receive a regular examination on a 12-month interval.

These guidelines above are minimums. Regular examinations may be conducted on a shorter cycle or supplemented with targeted examinations as needed. As noted previously, the supervision by risk process should be continuous. Examination schedules should be flexible and guided by the identification and monitoring of higher risk areas within an individual savings association.

CHAPTER: Examination Administration

SECTION: Examination Planning and Control

Section 040

Introduction

This section defines the types of trust and asset management examinations and discusses the considerations and techniques involved in proper planning and control of these examinations.

Types of Examinations

Consistent with examinations in other areas, there are three principal types of trust and asset management examinations: regular, targeted and special.

A **regular examination** is an examination of an institution's trust department in which all necessary and applicable regulatory procedures are performed by the examiner. The regular examination is triggered by the rating assigned at the previous examination under the Uniform Interagency Trust Rating System (see Section 060). The trust department will always be assigned a rating at the completion of a regular examination.

A **targeted examination** is one that focuses on either outstanding items from the previous examination (i.e., areas identified as needing improvement or correction) or a review of selected areas (i.e., one or two specific types of accounts, new fiduciary services or compliance with a new regulation). A trust department can be assigned a new rating as a result of a targeted examination. If a targeted examination uncovers serious deficiencies in the trust department, it should be discontinued and a regular examination should be commenced.

A **special examination** is conducted for the initial six month review of denovos and in response to special or dictated circumstances. For example, if a regional office receives a complaint alleging mismanagement of a fiduciary account, an on-site investigation may be necessary to properly respond to the complaint. A trust department can be assigned a new rating as a result of a special examination.

Examination Planning Objectives

Planning an examination provides direction and is essential in order to effectively and efficiently conduct the examination. It is during the planning process that decisions can be made regarding the overall objectives of the particular examination, the scope of the particular examination, the examination procedures to be used and the probable extent of testing and personnel requirements. The overall objectives of this phase of the examination process are to:

- collect and review as much information as possible prior to the on-site examination (or arrange for it to be available on-site at the start of an examination or at a preexamination scoping visit), so that the examination team can perform its work more efficiently on-site;
- minimize the amount of time spent during an examination waiting for essential data from the institution;
- develop a clearer understanding of the volume of trust and asset management activity, types of trust and asset management services and other information necessary to determine the examination scope, including activities that have transpired since the last examination;

- assist in determining personnel requirements and assigning areas of responsibility; and
- assist in estimating on-site examination time.

Prior to the commencement of a trust and asset management examination, the examiner should obtain and review all sources of information regarding the institution and its trust department, including (to the extent that each exists):

- the most recent trust and asset management examination report and workpapers;
- the most recent thrift, operating subsidiary, service corporation and/or state examination report;
- the most recent Annual Report of Trust Assets or TFR filed;
- business plan;
- conditions of approval of any applications;
- the most recent audit report; and
- any correspondence or other materials relating to activity that has transpired since the previous examination (e.g., directors' response letter, consumer complaints, request for rulings, outstanding enforcement actions, etc.).

The examiner should, if possible, discuss the institution and its trust department with the previous examiner-in-charge.

Trust PERK

Keeping in mind that examination efficiency leads to a better overall work product, the institution should be asked to submit all or part of a completed Preliminary Examination Response Kit (PERK) prior to the on-site portion of the examination. The information not submitted in advance should be available on-site at the start of the examination. The collection and review of the information in the PERK should help minimize the examination time spent on-site. A copy of the trust and asset management PERK is contained in Section 041. The PERK is designed to be comprehensive and applicable to all savings associations, however, information requests may be added to or deleted from the PERK to accommodate the type and complexity of the institution or the examination. PERK information may be requested from management in three ways:

- Information marked with an "A" should be mailed to the EIC at least 10 business days prior to the start of the examination
- Information marked with an "X" should be provided to the EIC at examination commencement
- Information marked with an "R" should be made available for on-site review

If you elect to have information mailed prior to the on-site portion of the examination, the PERK should go out a few days earlier than recommended in the normal customer service standards. Examiners should not require savings associations to photocopy and ship materials if it creates rather than reduces regulatory burden. Regulatory staff should gauge the resources and attitudes of each institution when requesting off-site delivery.

Examination Scope

Setting the scope of an examination is a critical component of the examination process, yet it is a process under which definitive and precise guidelines, equally applicable to all departments in all instances, cannot and should not be provided. Nevertheless, the following paragraphs discuss some broad parameters that should be considered when setting the examination scope. As noted throughout this handbook, the scope of an examination relates to a particular subject area and a number of specific factors should be considered, not all of which may be evident prior to the on-site portion of the examination. Most importantly, the scope must be tailored to fit the individual circumstances that exist in a department.

- * Examination scope must be established in stages. Throughout this entire process, setting the examination scope is closely related to the examination approach. The first stage consists of reviewing comments contained in past examination and audit reports, workpapers and other preexamination materials. This will aide examiners to develop a feel for the trust department's previous condition. If any adverse matters were contained in those materials, they should be specifically reviewed at the subsequent examination in order to ensure that appropriate corrective action was taken. This follow-up review would include verifying any assurances given by management in its written response to the previous report of examination that any adverse matters had received appropriate attention. Similarly, any significant matters that have transpired between examinations should be incorporated into the examination scope.
- * The extent of internal or external audit coverage should be determined and any audit reports issued since the last examination should be reviewed. This review may allow the examiner to formulate initial conclusions concerning audit coverage, indicate additional areas for examiner review (e.g., follow-up of exceptions noted in the report) and aide in delineating examination procedures to perform or not perform (e.g., if certain procedures were performed by auditors, the examiner would ordinarily not duplicate those procedures unless significant weaknesses were noted).
- * An assessment should be made to determine whether the institution has implemented a formal risk management and compliance program. Reports issued by these two functions should be reviewed at the start of the examination and, as with the review of the audit coverage, a determination should be made as to the effectiveness of these programs. If it is evident that the management oversight provided by audit, compliance and risk management programs is sound, a reduction in examination scope may be warranted.
- * The preliminary scope will often be expanded, contracted or otherwise refined once the on-site portion of the examination begins, as a result of additional information obtained from management conferences and initial review of policies, procedures, internal control reports, files and ledgers. For example, the lack of policies or procedures in a given area would generally indicate a need for testing, since an examiner cannot conclude that practices conform to a nonexistent policy or procedure. In addition, development of and compliance with, any new or revised policies or procedures would ordinarily be reviewed in more depth than existing ones.
- * Finally, the scope may be adjusted once the examination has begun. The depth of review accorded to individual subject areas should be dependent upon the degree to which there has been activity in that area in a particular department. For example, topics such as experience level and adequacy of staffing would be reviewed in greater depth if a department had experienced substantial turnover since the last examination, in contrast to a department in which personnel had remained relatively stable. Similarly, the area affected by the turnover would be reviewed in greater depth. In situations where there are new hires, such as a new account administrator, a sample of his or her accounts may be selected for review.

Examination Procedures

Examination programs are organized in a top-down fashion and are divided into three groups, each representing a different level of review: Levels I, II and III. The top-down approach begins with a review of policies, procedures and internal controls while focusing on the overall condition of the institution (Level I). With this approach, regulatory personnel can assess the degree of risk in each area of an institution's operations early in the examination and determine the depth of review and the procedures (Levels I, II and III) needed.

The optional topic questions following the programs are intended to serve as guides and reminders for the examiners. Less experienced examiners will find the questions especially useful as guides for the effective completion of assigned phases of examinations. More experienced examiners should use the optional topic questions as reminders of what is expected to be reviewed within each phase of an examination.

Not all programs will be applicable to an institution, and furthermore, of those programs used for a particular examination, not all procedures will be needed. The examination scope should help determine the level of review.

When using this risk-based examination approach, the examiner should use sound professional judgment to ensure that the depth of review is adequate but not excessive. The following is a discussion of the three levels of procedures available to the examiner.

Level I

Level I procedures focus on the review of examination scoping materials; institution and regulatory documents; policies and procedures; relevant PERK documents; ECEF reports; previous examination reports; and committee minutes. In addition, the Level I review is followed-up by interviews with personnel to determine if practices conform to written guidelines and to confirm any other preliminary findings.

If items of concern are uncovered during Level I analysis or if problems were identified during the preexamination monitoring and scoping, the examiner may need to use some or all Level II procedures.

Level II

Level II procedures focus on further institution materials and management reports, as well as more in depth interviews. These procedures may also include reviewing a small sample of account files and/or transactions to support a conclusion for a specific area.

Level I and selected Level II procedures normally provide a comprehensive analysis from which conclusions can be drawn but do not include any significant auditing procedures. If the examiner cannot rely on the data contained in institution records, Level III procedures may be necessary.

Level III

Level III procedures include steps that auditors usually perform. Although certain situations may require Level III procedures, it is not standard practice of Office of Thrift Supervision (OTS) examiners to duplicate the testing efforts of auditors.

Again, it may not be necessary to complete every program or every procedure within a program. The examiner has the discretion to determine which programs and procedures are necessary to address the scope

and reach a sound conclusion. In some situations it may be even appropriate to customize existing procedures or to perform procedures that are not listed within a program in order to achieve the most efficient and meaningful analysis. The examiner should, however, document any decisions to deviate significantly from the initial scope instructions or to modify existing procedures on the relevant programs.

Examination Management

Once the examination materials are obtained and reviewed, the “examiner in charge” (EIC) should be in a good position to identify areas of the institution’s operations where examination time can best be focused. For example, if the response to the PERK lists a number of transactions with affiliates or discretionary use of affiliated products or the savings association’s securities, examination resources should emphasize the conflicts of interest area of the compliance section. In addition, review of the information should assist the EIC to determine with greater precision the specific work assignments to be completed and in turn, enable the EIC to assign that work to other members of the examination team. The EIC should also discuss or prepare a memorandum for the examination team addressing the preliminary examination scope and the rationale for that scope with emphasis on any special concerns disclosed as a result of the examination analysis and review process.

Once the examination has begun, the EIC must closely monitor its progress and supervise and coordinate the work of the examination team. Any adjustments in the scope of the examination should be made as early as possible or, if in response to current circumstances, immediately. As assignments are completed, the EIC should review workpapers to ensure that they are factually complete, that they support the conclusions reached and that any deviations from the initial scope are documented and explained.

At the start of the examination, the EIC should meet with the savings association’s executive management (including management of the institution and the trust department). The meeting should discuss the department’s general condition, changes in key personnel, strategic planning and business activity that have occurred since the previous examination. The EIC should introduce any other members of the examination team and convey the anticipated scope of the examination. Executive management should introduce staff responsible for the most important areas of the trust department and provide a contact person if examiners need assistance. Examples of key personnel in a larger department would include the compliance officer and persons responsible for trust operations, trust investments and account administration.

In addition to the above objectives, this initial meeting should strive to establish an effective working relationship between the examiners and management to expedite the examination process and minimize operational intrusions. As is the case with examinations in other areas, examiners must observe the highest standards of professional and personal conduct. Examiners are often the only representatives of OTS that the savings association meets; it is therefore important that a favorable impression be made. The EIC should structure the examination in such a manner as to minimize disruptions and intrusions of department personnel and activity.

The EIC should determine what additional information will be needed during the examination, at least initially. This determination can be based on a number of factors, including the EIC’s overall experience or previous experience with the particular department, the extent of information requested (and received) during the preexamination planning process and the information maintained by and in the department (i.e., computer runs and management reports). Section 042 summarizes typical information maintained by a department that may be useful to the examination team.

Throughout the examination, the EIC should continue to meet with senior management to discuss the status of the examination. These meetings should be viewed as a vehicle for improving an understanding of the trust department's processes as well as informing management of any critical areas of concern. When possible, the EIC should identify areas where corrective action will be necessary, obtain management's concurrence and suggest that such action be implemented immediately. If corrective action is implemented during the examination, it should be noted in the report of examination.

Examination Conclusions

The ability to formulate conclusions, prioritize findings and communicate those findings to trust department management, boards of directors and OTS personnel is crucial to the regulatory and supervisory process. As individual examination assignments are completed and workpapers compiled, the EIC should begin to formulate an impression of the department's overall condition. The objectives of developing examination findings and conclusions in preparation for the closing conference with senior management and the report of examination are:

- to review all major findings from the examination (including work performed by assistants if not previously reviewed) and to verify that all assertions of facts or opinions are substantiated in the workpapers;
- to convert the assembled information into a unified assessment of comments and conclusions relative to specific subject areas or practices, the department's present condition, future prospects and its adherence to sound fiduciary practices;
- to formulate recommended corrective action when appropriate, based on those comments and conclusions; and
- to communicate the results of the examination to appropriate personnel in the department, institution and OTS through the closing conference and the report of examination.

Conclusions and recommendations should be based on objective information gathered during the examination. In order to attain their maximum effectiveness, conclusions must be drawn from a comprehensive analysis of patterns and practices. Although individual violations or other significant and substantive deficiencies must be dealt with, emphasis on the pattern or practice, the cause of the violation, will not only bring about better and more effective corrective action but will also enhance future compliance.

This handbook, the trust rating system and the report of examination are all organized in terms of a department's overall exercise of trust powers and the exercise of those powers as it relates to five major subject areas. This format is also a convenient one in which to form conclusions and to organize the agenda of the closing management conference.

Management Discussions

The objectives of the closing conference are to inform the chief executive officer (and/or other senior management) of the examiner's evaluation of the department's condition and to reach agreement, where possible, on the accuracy of the issues presented and management's commitment to initiate appropriate corrective or other action based upon the examination findings. The closing conference should leave management and the examiner with a clear and mutual understanding of what items will appear in the report of examination and what the overall tone of the report will be. The examiner should present findings and conclusions as well as the potential composite and individual MOECA component ratings and be receptive to

any evidence presented by management that is contrary to those findings and conclusions. No critical items should appear in the report of examination unless they were discussed at this closing conference.

The personnel with whom the examiner should discuss the examination findings depend upon the nature of the findings, the structure of the savings association and past experience in communicating and correcting adverse matters. Isolated, technical or other nonsubstantive findings should be presented to the individual responsible (assuming they should be presented at all), such as the operations officer or the account administrator responsible for the individual account. Overall or significant findings and trends should be presented to senior management of the department and the chief executive officer of the savings association. Adverse findings related to audits should be presented to the internal auditor or audit committee.

The OTS examination approach emphasizes the role that a savings association's board of directors plays in establishing policies and procedures for the safe and sound operation of its trust and asset management activities. Since the OTS believes that board members, particularly trust committee members, should be involved in the regulatory process, it is important that they be given the opportunity to meet with examination personnel following an examination. Therefore, the practice of meeting periodically with the trust committee (or similar committee having board of directors' representation) and the full board of directors is encouraged in all instances. Participation in such meetings allows the examiner to communicate examination findings to a broad audience and fosters open communication, which should result in a better understanding of the respective roles of management and examiners. The examiner should also be able to evaluate the knowledge of, and degree of involvement by, those personnel in the operation of the trust department.

CHAPTER: Examination Administration

SECTION: PERK

Section 041

The following is a summary schedule of information to be provided to the Examiner in Charge at the commencement of the trust and asset management examination. The information will help ensure an efficient review of the savings association and minimize additional requests. Information from the institution's internal sources that gather the requested information in a manner practical for the institution should be considered adequate.

Management

1. Provide an organization chart of the trust and asset management department, the financial institution, its subsidiaries, affiliates and the parent holding company (if any) showing major divisions and principal officers.
2. Provide a list of the board of directors showing elected term, place of residence and employment.
3. Provide a list of all senior trust and asset management officers, showing title, salary and any additional bonus paid. Also include a resume and job description for each of these individuals including principal functions and amount of time devoted to the trust and asset management function with telephone numbers and office locations. Include a summary of the number and total salaries for all other trust and asset management personnel.
4. Provide a list of trust and asset management committees or other official groups responsible for the supervision or implementation of trust and asset management activities. Include purpose or function, frequency of meeting, present composition and qualifications of members serving on the committees.
5. Provide access to the board of directors meeting minutes along with related reports and attachments. Also, provide access to all trust and asset management committee minutes and/or minutes of other official groups responsible for supervising or implementing trust activities. Please provide the name of the individual(s) from whom the minutes should be requested.
6. Provide access to trust and asset management's new business or marketing plans including types of business solicited, minimum dollar size of accounts accepted, nature of new business efforts, competition, market potential and projected growth. Describe significant risks that the trust and asset management function faces, how those risks are communicated internally and to the board of directors as well as the mechanisms used to identify and address those risks.
7. Provide a letter from legal counsel describing any litigation, threatened or pending, against the institution in connection with its trust or asset management activities that has occurred since the last examination. Include the accounts concerned, the nature of the action, the amount involved, the present status and a statement as to the probable outcome and the cost to the institution.
8. Provide copies of or access to the trust and asset management policies and procedures manual(s).
9. Provide a copy of the insurance policies carried by the institution to cover trust and asset management activity errors and surcharge liabilities, and other applicable insurance policies, e.g. blanket bond, directors and officers liability insurance. Provide the date of the board's last review and approval.
10. Provide a list of the institution's assets pledged or deposited with state authorities (§550.490). Also, provide a list of the institution's assets to be used as collateral for fiduciary account assets awaiting investment or distribution that have been deposited with the savings association or an affiliate and the deposits are not covered by FDIC insurance policies (§550.310). Indicate market values for each security.

Operations

1. Describe the trust and asset management accounting system(s) and the related system(s) of internal controls. Provide a copy of any audits performed since the last examination.
2. Provide the names and describe any accounting, data processing, custody, or other support or operations related services performed by third parties (including affiliates). Provide copies of servicing agreements between the institution and such third parties.
3. Provide copies of the trust and asset management's data processing disaster contingency plan and/or a copy of the contract for disaster recovery services. Include the results of the most recent test of the plan.
4. Describe the system or process used to ensure that trust and asset management assets are physically segregated from the assets of the institution and that the assets are maintained under an effective system of joint custody and control.
5. Provide a list of any assets not in the possession of the trust and asset management department's. Include assets in possession of the department but not entered on its records. Exclude normal deliveries and exchanges.
6. Provide a list of all general ledger accounts utilized by the trust and asset management department's.
7. Provide reconcilements of demand and time deposits as of each month end for the three months preceding the examination.
8. Provide monthly overdraft reports for the past three months indicating accounts concerned and dates of inception. Provide the reason(s) for any overdrafts over 30 days and for any overdrafts greater than \$1,000.
9. Provide a list of cash management vehicles currently utilized.
10. Describe the institution's web site (transactional or nontransactional, products or services offered, services offered directly or indirectly, etc.) with specific reference to trust and asset management activities. If transactional, provide a copy of the web site notice filed with the OTS.
11. Provide a list of signature authorities for signing checks, executing documents, effecting asset sales and transfers, etc.

Internal Controls

1. Provide a copy of the institution's risk management program and the name of the individual responsible for the program. Describe the risk management process.
2. Provide copies of any risk assessments performed since the last examination.
3. Describe management's outsourcing oversight program and the process for the review of each service provider's controls, condition and performance.
4. Provide copies of independent audits and/or SAS 70's performed on any outsourced services.
5. Provide copies of the trust and asset management business continuity plans.
6. Provide copies of the trust and asset management compliance program and copies of any compliance audits or reports performed.

Audits

1. Provide a copy(s) of any trust and asset management audits conducted since the prior examination. Include auditor work programs used and management's response to audit findings. Provide a list of any outstanding audit items.
2. Describe the frequency and scheduling of trust and asset management audits and factors that influence audit frequency and scope.
3. Provide a copy of the most recent audit plan and the date that it was approved by the board of directors or the audit committee.
4. Provide a list of the audit committee members. Provide access to the audit committee minutes and the name of the individual to contact for reviewing the minutes.
5. Provide the name(s) of the company(s) or division(s) that conduct the internal and external audits. Provide any engagement letters.
6. Provide a list of the audit staff and describe its trust and asset management expertise and training. Also, provide an organization chart of the audit department. Describe the reporting and accountability relationship of the audit function within the institution.

Earnings

1. Provide a statement of condition of the trust and asset management department listing assets and liabilities.
2. Provide income statements of the trust and asset management department's earnings and expenses for the last three calendar years as well as budgeted amounts for the last three calendar years.
3. Provide the trust and asset management's budget for the current year. Also provide a year-to-date income statement.
4. Provide a copy of the institution's business and/or strategic plan. Also provide a description of the department's new business development efforts including types of business solicited, minimum dollar size of accounts that will be accepted, marketing strategies, competition, market potential and projected growth.
5. Describe any factors that had a significant impact on earnings and expenses since the last onsite examination.
6. Provide a list of any cash settlements, surcharges, losses, charge-offs and/or recoveries in excess of \$1,000 for the past three calendar years by calendar year. Identify and provide an explanation for any material (\$5,000) losses incurred.
7. Provide copies of the prescribed fee schedules for trust and asset management services and the date approved by the board or the appropriate committee. If fee schedules are not formalized, provide a statement as to the general practice in determining charges.
8. Provide a list of any fees billed but unpaid for six months or more.
9. Provide a list of accounts on which no fees or commissions are charged, and reasons why.
10. Provide a package or copies of marketing materials used for trust products.
11. Provide a copy of the most recent annual report for the institution or parent company.

12. Provide a copy of the institutions most recent thrift financial report.
13. Provide copies of the last three FFIEC Annual Reports of Trust Assets, including Schedule E.

Compliance

1. Describe the method used to identify and monitor potential conflicts of interest. Describe the nature of information maintained on potential conflict relationships (i.e., affiliates, directors' business interests, large commercial customers, etc.).
2. Describe whether the trust and asset management department, its subsidiaries or its affiliates receive any fees from affiliated or unaffiliated mutual funds (i.e., 12b-1 fees, shareholder servicing fees, subtransfer agent fees and shelf space). Does the pertinent state(s) statutes permit fiduciary account investment in mutual funds that pay fees to the savings association or its affiliates? Provide policies and procedures governing the acceptance of such fees as well as the use of proprietary products.
3. Provide a list of all holdings in the trust and asset management department of any stock or other obligations of the institution, or its affiliates. Show the accounts in which held, book and market values and the dates and manner of acquisition by account type and class. Identify all accounts originated since the prior examination.
4. Provide a list of all holdings in the trust and asset management department of any obligations of directors, officers or employees. Show the accounts concerned, book and market values, and the dates and manner of acquisition.
5. Provide a list of all holdings in the trust and asset management department of any securities of organizations in which directors, officers or employees has a substantial (i.e., over 10 percent) interest. List the accounts concerned, book and market values and the dates and manner of acquisition.
6. Provide a list of any organizations of which the shares held by the institution as fiduciary represent effective voting control by the institution, or of which the majority or controlling directors of the organization are directors or officers of this institution.
7. Provide copies of the most recent ethics disclosures for senior management.
8. Provide a copy(s) of referral fee disclosure documents provided to prospective customers. Also provide a copy(s) of written referral agreements between the institution and persons or entities making the referrals.
9. Provide access to customer complaints since the previous examination, with the status of resolution, if any.
10. Provide a trial balance listing major account categories and their total market value of assets and cash.
11. Provide a master list of accounts organized by type, account, and office. List the account administrator, investment manager, investment authorization, book and market values.
12. Provide a list of codes used to identify account type, office, class, investment authority, account administrator, investment manager, etc.
13. Provide a list of closed accounts since the prior examination, including the reason(s).
14. Provide a list of estates in the process of administration longer than 18 months for which the institution has not filed an accounting. Also, list all estates for which administration has exceeded 36 months.

15. Provide a list of all mortgages, notes receivable, and other obligation for which principal, interest or other payments such as rent are delinquent sixty days or more, for which taxes are delinquent and/or for which required insurance coverage is not currently in effect.
16. Provide a list of pending foreclosures involving mortgages held as trust and asset management assets.
17. Provide a list of real estate held as trust and asset management assets subject to prior liens.
18. Provide a list of real estate held by accounts where there are delinquencies in rental income.
19. Provide a list of accounts having liabilities, such as outstanding loan indebtedness or other borrowings. Indicate where account assets are pledged.
20. Provide a list of closely held companies, limited and general partnership interests, interests in unincorporated businesses and securities having limited marketability. Identify accounts concerned and discuss pricing and valuation policies.

Asset Management

1. Provide a list of accounts for which the trust and asset management department has any level of discretionary investment authority.
2. Provide a copy of the trust and asset management department's approved list of investments, if any. Include a list of any deviations from the list and explanations of those deviations in accounts for which the department has discretionary investment authority.
3. Describe how investment decisions are made and evaluated and the source of investment research information utilized by the trust and asset management department. Describe the process used to ensure that investment decisions are supported by adequate research and documentation and to determine that investment decisions made by third parties are properly authorized and documented.
4. Provide a list of individuals or institutions used on a regular basis to provide investment advisory or research information, asset-pricing services or to assist in the operation and management of real estate, etc. Please provide a copy(s) of service agreements.
5. Provide a list of brokers utilized and fees and commissions, including cost of trading on a per share basis, paid during the last calendar year.
6. Describe any soft dollar arrangements that exist. Provide a copy(s) of any service agreement between the broker(s) and the institution.
7. Provide a list of any client accounts with loans secured by margin stock pledged for the purpose of purchasing or carrying securities. If the institution is subject to Federal Reserve registration, provide copies of respective Reg U filings.
8. If you are a registered investment adviser, provide a copy(s) of the ADV and any amendments filed since the prior trust and asset management department examination.
9. Provide a list of all common and collective funds in which trust assets are invested. Also, provide a description of each fund, market value, most recent valuation report, financial performance, and the most recent audit date. Provide a list of the participating trust accounts in each common and collective fund.
10. Provide a list of all proprietary mutual funds in which trust and asset management assets are invested. Include a recent prospectus and any supplemental information (i.e., statement of additional information) for each fund, plus a one year, three year and five year performance comparison with like

indices. Provide a list of the participating discretionary fiduciary accounts invested in each proprietary mutual fund.

11. Provide a list of all other mutual funds in which trust and asset management assets are invested. Provide the most recent prospectuses, plus a one year, three year, and five year performance comparison with like indices.
12. Has the state(s) where you conduct fiduciary activities adopted a version of the Prudent Investor Rule, or has the state(s) retained its version of the model prudent man rule? Describe your process for determining that discretionary account investments meet the appropriate state prudent statute.

CHAPTER: Examination Administration

SECTION: Useful Reports

Section 042

Reports Maintained

There are a number of reports that a savings association's trust and asset management department will have available from its recordkeeping system. These reports can be a valuable aide in an examination. Familiarity with the names, content and availability of these reports can expedite the examination process.

The set of books and records maintained by a trust and asset management department varies in accordance with the volume and complexity of business and whether or not the department is automated. If a department is automated, the reports maintained will vary in accordance with the automated system. While automated systems and service organizations provide a variety of reports, the information in those reports is reasonably similar. The following is a summary, by no means exhaustive, of the reports that should ordinarily be available and their contents. The same or similar reports are usually available in several ways; for example, they can be sorted alphabetically, by account number or by some other code.

Some servicers may provide an "examiner's package" that will have most of the information necessary for the examination. Others may provide a layered package so the examiner can choose the reports of interest for the examination.

Account Assets by Trust Report (also called Holders' List). Lists asset holdings for each individual account. May include transactions for a given period such as monthly. Typically used by department (and examiners) for individual account reviews.

Accounts opened, closed and saved. Same information as title indicates.

Account Synoptic Report. Report reflects information coded for an overall account profile based on several transaction types. Includes account type, account status, check cross-reference records, fee statement remitter and recipient, IRS information reporting cross-reference records, investment officer, investment mix objective, last customer statement date, last fee computation date, last fee payment date, pending item file record, performance calculation, names and tax ID numbers and tax service interface. It is a companion report to the asset management review. It is also often called an "account digest".

Annual Report of Trust Assets. Report provides the data needed for the preparation of the Annual Report of Trust Assets (FFIEC 001).

Brokerage Fee Report. Lists brokers utilized by the department, the number of trades executed, and the commissions paid to them. Provides examiners with required brokerage fee allocation information.

Codes Report. Defines the various codes used in other reports, for example, lists the codes for administrative and investment managers, investment powers (discretionary vs. directed), investment retention (general vs. specific) and other tickler-type codes. This document is essential to an understanding of the other reports.

Daily Cash Report (Large Cash Balances). Provides cash balances for all portfolios of all accounts, subdivided by income and principal cash and, perhaps, by invested income. A sort of this report, or in some instances a separate report, shows cash balances above a certain preselected amount. Used to review cash management practices.

Daily Investment and Cash Report. Report reflects various control balances for all accounts each day. Used to monitor money market and/or other cash equivalent by administrative and operational personnel. Specific CUSIPs, asset types and/or total shares/par value of all assets in each account are listed. Net amount of pending trades for each account is reflected.

Daily Transaction Report. A multi-purpose report that serves as an informational aide to administrative and operational personnel. Since activity is segregated by officer code, each officer may review his/her own account transactions.

Detailed Transactions (for an account). Report used to review part or all of an account's transactions during the last thirteen months.

Dividend and Interest Account, Suspense Account or Balancing Totals Report. Reports show items that are due to the department, and for how long, and other items that represent out of balance or other unusual conditions. Reports have a variety of names and may be combined or separated into several reports. Larger departments will have separate reports to address such items as delinquent fees, overdue loans, etc.

Fee System Exception Report. Captures any account that is not being charged in accordance with current fee schedule.

Large Balance and Overdraft Report. Report designed for a quick review of all accounts that hold cash in excess of a designated amount or have an overdraft in income or principal.

Location Report. Provides a list of assets held at specific locations. Used in a review of operations and controls to determine the volume and nature of assets held elsewhere.

Market Value Report. Shows the market value of each major asset held by the department. May also provide the price (book value) of the asset, number of shares or units held and percent the asset represents of total trust department assets. Used to review asset administration.

Master List of Accounts. Lists all accounts, usually with asset totals; may have other information such as discretionary vs. directed. Useful for account administration. Helpful in testing - shows largest accounts, etc.

Monthly Purchases Report. Tool for trust committee meetings to review the prior months activity. For administrative or operational review as a checklist to insure written direction or approval has been received on all required purchases.

Overdraft Report. Lists trust accounts that have a negative cash balance. May show amount of time that the negative balance has been present. There may be a code that shows whether or not income and principal cash can be netted. Used to review cash management practices.

Pending Account Action Planning Report. Report designed as an alert to certain actions or reviews that may be necessary. It is divided into six separate reports, and each report is broken down by officer. They are:

- committee reviews - a list of accounts that are scheduled for review as of the end of the following month;
- fees due - provides list of accounts scheduled to be charged fees as of the end of the following month;

- customer statements - provides list of accounts scheduled for customer statements as of the end of the following month;
- tax year-ends - provides list of accounts which will have a year-end as of the end of the following month;
- critical dates - provides list of accounts which have a “critical date” coded into the account master data record which occurs during the next three months or has occurred sometime in the past; and
- new accounts - provides list of accounts that have had a “date opened” in the account master record during the last two months.

Pending Items Reports. Shows certain types of activity that are prescheduled. Reports are:

- pending items map - a daily report reflecting all items scheduled for automatic or manual release each day;
- pending items master file report - a monthly report reflecting all records on the pending items master file at month end; and
- demand pending items master file records report - overnight demand report for a specific account, specific CUSIP, specific transaction code or a 30-day look ahead basis.

Pending Trade Report. Report reflects information relative to security purchases and sales executed but not yet settled.

Receipts and Disbursements. A chronological listing of the account’s transactions for the customer statement period. It is normally furnished to the customer as part of a total customer statement.

Security Cross-Reference Report. Lists holders of each type of trust security by account name and number. Thus, for example, IBM common stock is held in 30 accounts, with the number of shares given for each. Used in asset administration by helping to identify holdings of nonapproved list assets.

Security Pricing Report. Provides pricing and dividend information on the securities held by trust accounts. May be used as a checklist of securities owned which do and do not receive automatic pricing and dividend information by the pricing service.

Statement of Condition (Balance Sheet, General Ledger; reports may be combined or separate). Provides assets and liabilities of the department. Report should ordinarily be included in the PERK package. Useful for an overall view of the department and for examination scoping.

Statement of Transactions. Usually furnished as a part of the annual customer statement package along with the summary statement of transactions. Yearend package also includes the review of assets, the statement of capital gains and losses and the summary of dividends and interest.

Trial Balance. Lists major account categories (e.g., personal trusts, estates, etc.) and their totals for cash (sometimes subdivided into income and principal) and assets. May also be available in reverse for assets (e.g., lists assets subdivided by major asset category—stocks, corporate bonds, real estate, etc.—and types of accounts). Useful for an overview of the department, for examination scoping and as a starting point for asset reviews.

Trust Department Balance Sheet. Reflects cash and investments for each account on the asset side at cost. The liability side reflects the total number of accounts by type and cash and investments at cost.

Trust Reconciliations. For banks using depository arrangements with other banks or institutions, reconciliation is necessary to compare securities coded on the system as being held at the depository with a listing of securities from the depository. The report is intended to point out any discrepancies.

Unique Asset Report (Miscellaneous Asset). Lists unique assets for accounts such as promissory notes, real estate mortgages, closely held companies, etc. Used in review of asset administration.

CHAPTER: Examination Administration

SECTION: Report Preparation and Issuance

Section 050

Introduction

This section contains instructions for preparing and issuing a trust and asset management examination report (Report).

The report is furnished to the savings association for its confidential use and is written primarily for the benefit of the board of directors and senior management. Its overall tone should therefore be consultative and its content designed to educate. The report format is narrative and follows the trust rating system (see Section 060). However, its specific content is tailored to each individual trust department.

Objectives and Overall Guidelines

A comprehensive reporting system is utilized to communicate significant findings revealed during the trust and asset management examination. This system provides an objective assessment of a trust department's operations, identifies major strengths and weaknesses and identifies the source of any problems. The objectives of the report and the report preparation process are:

- to inform OTS personnel, the savings association's directors and trust department management of the trust department's overall condition and its major strengths and weaknesses;
- to effect correction of any adverse matters in a manner consistent with the best interests of account beneficiaries and other interested parties; and
- to provide OTS personnel with a complete and accurate assessment of the savings association's administration of its fiduciary powers.

The report should be accurate, concise and reasonably uniform. Accurate reporting is essential to the proper understanding and, in turn, the proper correction, of adverse matters contained in the report. All conclusions must be logical extensions of facts that are documented in the report and workpapers. Concise reporting aids the reader in understanding and interpreting report comments. Therefore, care should be taken to provide all essential data in a concise, logical and readily understandable manner. There should only be enough detail to enable the reader to understand the regulator's concerns. The reasonably uniform preparation of the report will enable OTS personnel to properly and quickly understand the condition of a trust department and provide a reasonable and consistent basis to compare trust departments both within a particular regional office and nationwide.

The report presents the significant findings of an examination. The examiner may exercise discretion in determining what specific matters are of sufficient importance to require comment in the report and, if so, their location in the report (i.e., summary vs. body). In so doing, however, the examiner must keep in mind the purpose and objectives of the report. In addition, the facts and circumstances in a specific savings association will dictate what items are considered significant or substantive. Within those parameters, the following guidelines are provided.

Significant violations of laws, regulations, rulings or sound fiduciary principles should be reported.

The absence of, or major weaknesses in, trust department policies, practices and controls should be reported. Such matters are likely to adversely affect a large number of accounts.

Actions or practices that have resulted in significant liability to the savings association, or that could result in liability if left uncorrected, should be reported. Similarly, significant pending or threatened litigation, settlements or compromise actions should be reported. Isolated exceptions that impact an individual account(s) should only be reported if the account(s) has or is likely to sustain a significant loss.

Any recurring items of criticism should be reported, regardless of their significance. In such a case the significance lies in management's lack of correction rather than the item itself. One result of this treatment may be that a comment contained in the body of the first report (i.e., significant enough to warrant inclusion in the report but not significant enough for the summary page), may be included on the summary page in a subsequent report.

Violations that are isolated, technical, minor, inadvertent or not indicative of overall department practices should not be reported, unless management is unable or unwilling to correct these items during the examination, they are repeated from a previous examination or they are symptomatic of an overall weakness. These violations should, however, be discussed with management and documented in the workpapers, as appropriate.

Similarly, the report should not contain extensive schedules of detailed information or lists of individual exceptions. Instead, these items should be furnished to trust department management and/or documented in the workpapers, depending upon their significance. Report comments can then be limited to a more general description of the underlying cause of the problem, with a reference to any detailed lists or schedules furnished to management.

As noted in Section 040, Examination Planning and Control, examination findings and conclusions should always be discussed with trust department management and other appropriate personnel prior to inclusion in the report.

Structure and Content

Examination Overview

The purpose of this section is to explain the examination methodology, detail the scope of the examination, summarize significant findings in regard to the savings association's management of its trust and asset management responsibilities and offer recommendations for improvement. This section contains subsections as explained below.

Scope

The scope subsection identifies the type of examination (regular, targeted or special). It should state the purpose of the examination, which is to evaluate how well the savings association manages its trust and asset management responsibilities and to gain an overview of the general condition of the trust department. An examination should not consist of a detailed review of compliance with all laws and regulations in order to identify violations. It should describe the overall areas reviewed but not provide details as to the precise depth of that coverage. Those details are to be presented in the workpapers. To illustrate, an appropriate comment in regard to account administration would be: "We reviewed individual accounts to determine if the department's policies are followed and to determine whether necessary documentation was present." Conversely, an inappropriate comment would be: "We reviewed seven personal trust accounts, six employee benefit accounts..."

In order to avoid the impression that a wider coverage was made than was actually undertaken, an examiner may wish to note those areas that received either limited or no coverage. Similarly, if the scope of the examination was influenced by any special factors, such as the prior trust or audit reports, comments to that effect would be appropriate. For example, an appropriate comment would be: “Since the audit report completed just prior to this examination included a verification of assets and since no major weaknesses were noted, we did not perform asset verification procedures during this examination.”

Finally, this subsection should describe the closing meeting with management. It should indicate that examination findings were presented to management and with whom those findings were discussed.

Executive Summary

This subsection should be the focal point to report overall conclusions, both positive and negative, that result from an examination. This subsection should address the following:

- matters of particular significance contained elsewhere in the report (e.g., a brief description of the most significant or critical problems, deficiencies or violations);
- overall improvement or decline since the last examination; and
- composite rating assigned to the savings association’s trust and asset management activities under the Uniform Interagency Trust Rating System.

The subsection should not be used as an index to all comments contained in the body of the report, nor should it contain minor comments. Matters of particular significance should be addressed in order of their importance regardless of the order in which they appear in the body of the report. The rating assigned should be justified by specific language tailored to the savings association. While the language in the Uniform Interagency Trust Rating System can be used for guidance, it should not be quoted verbatim. Any pertinent background information can also be summarized in this subsection, such as the size, location, nature of the trust and asset management activities or other similar descriptive data, but it should be brief. For example, in de novo trust and asset management examinations, this subsection might contain the following comment: “ABC was chartered by the OTS in January 2000 and this is the institution’s first trust and asset management examination. As such, we placed significant emphasis on reviewing the organizational structure, management reporting and written policies and procedures.”

Matters Requiring Board or Management Attention

This section should contain any recommendations for correction of adverse findings or suggestions for future improvement. All matters requiring board or management attention should be bulleted and listed in descending order of importance under each MOECA heading. Matters of primary importance should be briefly discussed within the context of the particular comments contained in the summary subsection. Significant issues should then be fully discussed in the significant regulatory findings section, depending upon the nature and extent of the findings and recommendations and the examiner’s opinion as to how best to present those items. If formal corrective action is recommended, completion dates for implementation of the corrective action should be included.

Significant Regulatory Findings

The purpose of this section is to identify significant regulatory issues and violations that warrant specific corrective action. All substantive findings should be identified (refer to discussion of substantive findings

under “Objectives and Overall Guidelines” above). The discussion of each finding should be concise and indicate the underlying cause(s) of the finding. Consistent with other sections of the report, the overall tone should be positive and consultative and the objective should be to lead the reader to agree that correction of cited deficiencies is not only possible but in the best interest of the savings association.

The body of the report is organized to coincide with the trust rating system. As such, it contains five major divisions: management; operations, internal controls and auditing; earnings; compliance and asset management (MOECA). The factors noted under “coverage” in each of those subject areas in the Uniform Interagency Trust Rating System (and similar factors) comprise the subsections.

Each of the five major divisions should begin with an overview of the department’s compliance with that topic. Individual violations or other deficiencies should then be briefly discussed, beginning with the most critical or substantive item. The discussion of a particular violation or other adverse matter should include (as applicable):

- a description of the problem, including how it occurred and the exact citation if it involves any statutory or regulatory violation;
- the extent of the problem, including a projection of the violation’s anticipated frequency of occurrence throughout the department based on the examination sample;
- an estimate of the financial or other risk to the department/institution created by the problem;
- the underlying cause of the problem, if it can be determined;
- the examiner’s recommendation(s) for corrective action; and
- management’s response (whether it agrees or disagrees and any assurances given).

If the comment involves an individual account, pertinent information relating to that account should be contained in the comment. However, if as a result of individual account comments there are suggestions for overall improvements, these should be addressed in the summary rather than repeated numerous times in the body of the report.

Issuance of the Trust and Asset Management Examination Report

The trust and asset management examination report should be issued to the savings association’s board of directors as soon as practicable after the completion of the on-site portion of the examination, since the overall impact and usefulness of the report can be directly correlated to the timing of its issuance. The passage of an unreasonable length of time between completion of the on-site examination and issuance of the report may give the impression to the savings association that any problems noted during the examination and contained in the report must not be as serious as management was led to believe.

In order to achieve the maximum utility from an examination report and to enhance its impact, it is suggested that regional offices develop internal procedures to process trust and asset management examination reports so their issuance can occur in a timely manner, generally within 45 calendar days after completion of the on-site examination. This time period is designed to assure that the information contained in the report reaches the board of directors promptly. If the report contains serious violations of laws, regulations or standards of fiduciary conduct, the regional office should consider expediting its internal processing to enable the report to be issued in a shorter time period. In instances where the safety and soundness and trust and asset management examinations are performed concurrently, the regional office may opt to transmit both completed reports simultaneously.

Transmittal Letters

The examination report includes a letter to a savings association's board of directors that officially transmits the report. In addition to the formal act of transmitting the report, this letter serves an important and substantive function in terms of the overall regulatory process. It is one of the primary communication tools used by OTS to bring to the attention of a savings association's senior management and its board of directors the significant findings and recommendations that result from the examination process. The letter can also serve as an important enforcement tool, in that it should make an institution's management acutely aware of the severity of any problems and impose reasonable timeframes for taking, or reporting on the progress of, corrective actions.

Naturally, the examination findings dictate the tone of this letter. For example, in a problem-free department, the transmittal letter would simply transmit the report. On the other hand, where the report contains significant matters for the directors' and managements' attention, the transmittal letter should convey the seriousness of the regulatory findings and express the regional office's concern about the condition of the trust department. The letter should ask that the board of directors formally acknowledge receipt of the examination report and set forth a time limit for the board to respond to the examination findings, usually no longer than 30 days. At a minimum, a specific response should be requested for matters commented on in the report. Transmittal letters should be prepared and submitted for review within the draft report.

The board's response should contain a detailed explanation of the actions it will initiate to bring about corrective action. Copies of any pertinent information, if requested in the transmittal letter, should also be included in the response. For example, policies, procedures, internal memoranda or legal opinions which management has prepared to address the concerns contained in the report. The response should be closely reviewed upon its receipt. The regional office should address any inadequate, unclear or otherwise unresolved matters in follow-up correspondence. Close attention to this process will accomplish several objectives; management's response will provide proposed or already-taken corrective action and both parties will have their concerns documented in writing. The writings will, in turn, foster more open and effective communications. Review of the response, including any necessary follow-up, will allow the supervision and regulation of the savings association to continue on an ongoing basis. As a result, outstanding items should not remain unresolved until the next examination.

CHAPTER: Examination Administration

SECTION: Assignment of Ratings

Section 060

Introduction

The Uniform Interagency Trust Rating System (UITRS) is an internal supervisory examination rating system used by the federal banking agencies for evaluating the administration of trust and asset management activities of financial institutions and uninsured trust companies on a uniform basis and for identifying those institutions requiring special supervisory attention. The UITRS was revised and updated by the Federal Financial Institutions Examination Council. All the federal banking agencies adopted the new rating system that became effective on October 13, 1998. The OTS, in Transmittal TR-215, December 29, 1998 gave notice of its adoption of the updated rating system for all trust and asset management examinations commencing after January 1, 1999.

Under the UITRS, each institution is assigned a composite rating based on an evaluation and rating of the essential components of an institution's trust and asset management activities. The composite rating reflects the overall condition of an institution's trust and asset management activities and is used by the federal banking agencies to monitor aggregate trends. Each individual component rating, particularly the management component, emphasizes the quality of the institution's risk management and oversight system.

The UITRS considers certain managerial, operational, financial and compliance factors that are common to all institutions with trust and asset management activities. Under this system, the supervisory agencies endeavor to ensure that all institutions are evaluated in a comprehensive and uniform manner and that supervisory attention is appropriately focused on those institutions exhibiting weaknesses in their trust and asset management operations. Each rating area explicitly identifies the risk types that are considered in assigning ratings.

The UITRS requires trust and asset management earnings to be evaluated at all institutions. However, OTS will assign a rating for the earnings component only for those institutions that, at the time of the examination, have total trust department assets of more than \$100 million or are a trust-only institution.

Overview of Trust Rating System

Under the UITRS, financial institutions are assigned a composite rating based on an evaluation and rating of five essential components of an institution's trust and asset management activities. These components address the following: the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with applicable law and fiduciary principles; and the management of trust department assets. Composite and component ratings are assigned based on a 1 to 5 numerical scale. A "1" is the highest rating and indicates strong performance, good risk management practices and the least degree of supervisory concern. A "5" is the lowest rating and indicates weak performance, poor risk management practices and, therefore, the highest degree of supervisory concern.

Evaluation of the composite and components considers the size and sophistication, the nature and complexity and the risk profile of the institution's trust and asset management activities. The composite rating generally bears a close relationship to the component ratings assigned. However, computing an arithmetic average of the component ratings does not derive the composite rating. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall administration of the financial institution's trust and asset management activities. Assigned composite and

component ratings are disclosed to the institution's board of directors and senior management, typically in the trust and asset management examination report.

The ability of management to respond to changing circumstances and to address the risks that may arise from changing business conditions, or the initiation of new trust and asset management activities or products, is an important factor in establishing an institution's overall risk profile and the level of supervisory attention warranted. For this reason, the management component is given special consideration when assigning a composite rating. The ability of management to identify, measure, monitor and control the risks of its trust and asset management operations is also taken into account when assigning each component rating. It is recognized, however, that appropriate management practices may vary considerably among financial institutions, depending on the size, complexity and risk profiles of their trust and asset management activities. For less complex institutions engaged solely in traditional fiduciary activities and whose directors and senior managers are actively involved in the oversight and management of day-to-day operations, relatively basic management systems and controls may be adequate. On the other hand, at more complex institutions, detailed and formal management systems and controls are needed to address a broader range of activities and to provide senior managers and directors with the information they need to supervise day-to-day activities.

All institutions are expected to properly manage their risks. For less complex institutions engaging in less risky activities, detailed or highly formalized management systems and controls are not required to receive strong or satisfactory component or composite ratings.

Composite Ratings

The five composite ratings are defined as follows:

Composite 1

Trust and asset management activities are sound in every respect. Generally, all components are rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by management. The institution is in substantial compliance with applicable law. Risk management practices are strong relative to the size, complexity and risk profile of the institution's trust and asset management activities. Fiduciary activities are conducted in accordance with applicable law and fiduciary principles and give no cause for supervisory concern.

Composite 2

Trust and asset management activities are fundamentally sound. Generally, no component rating should be more severe than 3. Only moderate weaknesses are present and are well within management's capabilities and willingness to correct. Trust and asset management activities are conducted in substantial compliance with applicable law. Overall risk management practices are satisfactory relative to the institution's size, complexity and risk profile. There are no material supervisory concerns and, as a result, the supervisory oversight is informal and limited.

Composite 3

Trust and asset management activities exhibit some degree of supervisory concern in one or more of the component areas. A combination of weaknesses exists that may range from moderate to severe; however, the magnitude of the deficiencies generally does not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate

timeframes. Additionally, there is significant noncompliance with applicable law. Risk management practices may be less than satisfactory relative to the institution's size, complexity and risk profile. While problems of relative significance may exist, they are not of such importance as to pose a threat to trust accounts generally or to the soundness of the institution. The institution's trust and asset management activities require more than normal supervision and may include formal or informal enforcement actions.

Composite 4

Trust and asset management activities generally exhibit unsafe and unsound practices or conditions, resulting in unsatisfactory performance. The problems range from severe to critically deficient and may be centered on inexperienced or inattentive management, weak or dangerous operating practices or an accumulation of unsatisfactory features of lesser importance. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. There may be significant noncompliance with applicable law. Risk management practices are generally unacceptable relative to the size, complexity, and risk profile of the trust and asset management activities. These problems pose a threat to trust accounts generally and, if left unchecked, could evolve into conditions that could cause significant losses to the institution and ultimately undermine the public confidence in the institution. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems.

Composite 5

Trust and asset management activities are being conducted in an extremely unsafe and unsound manner and are critically deficient in numerous major respects. Problems result from incompetent or neglectful administration, flagrant and/ or repeated disregard for applicable law or a willful departure from fiduciary principles and practices. The volume and severity of problems are beyond management's ability or willingness to control or correct. Such conditions pose a serious threat to the trust and asset management accounts and may pose a serious threat to the soundness of the institution. Continuous close supervisory attention is warranted and may include termination of the institution's trust powers.

Component Ratings

Each of the component rating descriptions is divided into three sections: a narrative description of the component; a list of the principal factors used to evaluate that component; and a description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship among components. The listing of evaluation factors is in no particular order of importance.

Management

This rating reflects the capability of the board of directors and management, in their respective roles, to identify and control the risks of an institution's trust and asset management activities. It also reflects their ability to ensure that the institution's trust and asset management activities are conducted in a safe and sound manner and in compliance with applicable law. Directors should provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures and practices are established and followed. Senior management is responsible for developing and implementing policies, procedures and practices that translate the board's objectives and risk limits into prudent operating standards. Depending on the nature and scope of an institution's trust and asset management activities, management practices may need to address some or all of the following risks: reputation, operating or transaction, strategic, compliance, credit, market, liquidity and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; hiring competent personnel; adopting and implementing adequate

policies, processes and controls that consider the size and complexity of the institution's trust and asset management activities; and establishing effective risk monitoring and management information systems. This rating should reflect the board and management's ability as it applies to all aspects of trust and asset management activities in which the institution is involved. The management rating is based upon an assessment of the capability and performance of management and the board of directors, including, but not limited to, the following evaluation factors:

- the level and quality of oversight and support of trust and asset management activities by the board of directors and management, including committee structure and adequate documentation of committee actions;
- the ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the introduction of new activities or products;
- the adequacies of, and conformance with, appropriate internal policies, practices and controls that address the risks associated with trust and asset management activities;
- the accuracy, timeliness and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and trust and asset management risk profile;
- the overall level of compliance with applicable law and fiduciary principles;
- responsiveness to recommendations from auditors and regulatory authorities;
- strategic planning for trust and asset management products and services;
- the level of experience and competence of management and staff, including issues relating to turnover and succession planning;
- the adequacy of insurance coverage;
- the availability of competent legal counsel;
- the extent and nature of pending litigation associated with trust and asset management activities and its potential impact on earnings, capital and the institution's reputation; and
- the process for identifying and responding to customer complaints.

A *rating of 1* indicates strong performance by management and the board of directors and strong risk management practices relative to the size, complexity and risk profile of the institution's trust and asset management activities. All significant risks are consistently and effectively identified and controlled. Management and the board are proactive, and have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

A *rating of 2* indicates satisfactory management and board performance as well as risk management practices relative to the size, complexity and risk profile of the institution's trust and asset management activities. Moderate weaknesses may exist but are not material to the sound administration of trust and asset management activities and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored and controlled.

A *rating of 3* indicates management and board performance that needs improvement or risk management practices that are less than satisfactory given the nature of the institution's trust and asset management activities. The capabilities of management or the board of directors may be insufficient for the size,

complexity and risk profile of the institution's trust and asset management activities. Problems and significant risks may be inadequately identified, measured, monitored and/or controlled.

A *rating of 4* indicates deficient management and board performance or risk management practices that are inadequate considering the size, complexity and risk profile of the institution's trust and asset management activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored and/or controlled and require immediate action by the board and management to protect the assets of trust accounts and to prevent erosion of public confidence in the institution. Replacing or strengthening management or the board may be necessary.

A *rating of 5* indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored and/or controlled and now pose a threat to the safety of the trust and asset management account assets and ultimately may threaten the continued viability of the institution. Replacing or strengthening management or the board of directors is necessary.

Operations, Internal Controls & Auditing

This rating reflects the adequacy of the institution's trust and asset management operating systems and internal controls in relation to the volume and nature of the trust and asset management activities conducted. Audit coverage must assure the integrity of the financial records, the sufficiency of internal controls and the adequacy of the compliance process. The institution's trust and asset management operating systems, internal controls and audit function subject it primarily to transaction and compliance risk. Other risks may also be present, including reputation, strategic and financial risk. The ability of management to identify and control these risks is reflected in this rating. The operations, internal controls and auditing rating is based upon, but not limited to, an assessment of the following evaluation factors:

- Operations and internal controls, including the adequacy of: staff, facilities and operating systems; record, accounting and data processing systems (including controls over system access and accounting procedures such as aging, investigation and disposition of items in suspense accounts); trading functions and securities lending activities; vault controls and securities movement; segregation of duties; controls over disbursements (checks or electronic); controls over unissued checks; controls over income processing activities; reconciliation processes (depository, cash, vault, subcustodians, suspense accounts, etc.); disaster and/or business recovery programs; hold-mail procedures and controls over returned mail; and proper escheatment of funds.
- Auditing, including: the independence, frequency, quality and scope of the internal and external audit function relative to the volume, character and risk profile of the institution's activities; the volume and/or severity of internal control and audit exceptions and the extent to which these issues are tracked and resolved; and the experience and competence of the audit staff.

A *rating of 1* indicates that operations, internal controls and auditing are strong in relation to the volume and character of the institution's trust and asset management activities. All significant risks are consistently and effectively identified, measured, monitored and controlled.

A *rating of 2* indicates that operations, internal controls and auditing are satisfactory in relation to the volume and character of the institution's trust and asset management activities. Moderate weaknesses may exist, but are not material. Significant risks, in general, are effectively identified, measured, monitored and controlled.

A *rating of 3* indicates that operations, internal controls or auditing need improvement in relation to the volume and character of the institution's trust and asset management activities. One or more of these areas are less than satisfactory. Problems and significant risks may be inadequately identified, measured, monitored and/or controlled.

A *rating of 4* indicates deficient operations, internal controls or audits. One or more of these areas are inadequate or the level of problems and risk exposure is excessive in relation to the volume and character of the institution's trust and asset management activities. Problems and significant risks are inadequately identified, measured, monitored and/or controlled and require immediate action. Institutions with this level of deficiencies may make little provision for audits or may evidence weak or potentially dangerous operating practices in combination with infrequent or inadequate audits.

A *rating of 5* indicates critically deficient operations, internal controls or audits. Operating practices, with or without audits, pose a serious threat to the safety of trust and asset management accounts. Problems and significant risks are inadequately identified, measured, monitored and/or controlled and now threaten the ability of the institution to continue engaging in trust and asset management activities.

Earnings

This rating reflects the profitability of an institution's trust and asset management activities and its effect on the financial condition of the institution. The use and adequacy of budget and earning projections by function, product lines and clients are reviewed and evaluated. Risk exposure that may lead to negative earnings is also evaluated. An evaluation of earnings is required for all institutions with trust and asset management activities. An assignment of an earnings rating, however, is required only for institutions that, at the time of the examination, have total trust department assets of more than \$100 million or are a trust-only institution. For institutions where the assignment of an earnings rating is not required by the UITRS, each federal banking agency has the option to assign an alternative earnings rating. It is OTS's policy to assign a rating to only those trust department with more than \$100 million or are a trust-only institution. The definitions for the alternate ratings are included in the revised UITRS.

The evaluation of earnings is based upon, but not limited to, an assessment of the following factors:

- the profitability of trust and asset management activities in relation to the size and scope of these activities and to the overall business of the institution;
- the overall importance to the institution of offering trust and asset management services to its customers and local community; and
- the effectiveness of the institution's procedures for monitoring trust and asset management activity's income and expenses relative to the size and scope of the activities and their relative importance to the institution, including the frequency and scope of profitability reviews and planning by the institution's board of directors or a committee thereof.

For those institutions for which a rating of earnings is mandatory, additional factors should include the following:

- the level and consistency of profitability, or the lack thereof, generated by the institution's trust and asset management activities in relation to the volume and character of the institution's business and the impact on the institution's level of capital;
- dependence upon nonrecurring fees and commissions, such as fees for court accounts;

- the effects of charge-offs or compromise actions;
- unusual features regarding the composition of business and fee schedules;
- accounting practices that contain practices such as (1) unusual methods of allocating direct and indirect expenses and overhead or (2) unusual methods of allocating trust and asset management income and expense where two or more institutions within the same holding company share services and/or processing functions;
- the extent of management's use of budgets, projections and other cost analysis procedures;
- methods used for directors' approval of financial budgets and/or projections;
- management's attitude toward growth and new business development; and
- new business development efforts, including types of business solicited, market potential, advertising, competition, relationships with local organizations and an evaluation by management of risk potential inherent in new business areas.

A *rating of 1* indicates strong earnings. The institution consistently earns a rate of return on its trust and asset management activities that is commensurate with the risk of those activities. This rating would normally be supported by a history of consistent profitability over time and a judgment that future earnings prospects are favorable. In addition, management techniques for evaluating and monitoring earnings performance are fully adequate and there is appropriate oversight by the institution's board of directors or a committee thereof. Management makes effective use of budgets and cost analysis procedures. Methods used for reporting earnings information to the board of directors, or a committee thereof, is comprehensive.

A *rating of 2* indicates satisfactory earnings. Although the earnings record may exhibit some weaknesses, earnings performance does not pose a risk to the overall institution nor to its ability to meet its obligations. Generally, trust and asset management earnings meet management targets and appear to be sustainable. Management processes for evaluating and monitoring earnings are generally sufficient in relationship to the size and risk of trust and asset management activities that exist and any deficiencies can be addressed in the normal course of business. A rating of 2 may also be assigned to institutions with a history of profitable operations if there are indications that management is engaging in activities with which it is not familiar or where there may be inordinately high levels of risk present that have not been adequately evaluated. Alternatively, an institution with an otherwise strong earnings performance may also be assigned a 2 rating if there are significant deficiencies in its methods used to monitor and evaluate earnings.

A *rating of 3* indicates less than satisfactory earnings. Earnings are not commensurate with the risk associated with trust and asset management activities. Earnings may be erratic or exhibit downward trends and future prospects are unfavorable. This rating may also be assigned if the processes management uses for evaluating and monitoring earnings exhibit serious deficiencies. However, the deficiencies identified must not pose an immediate danger to either the overall financial condition of the institution or its ability to meet its trust and asset management obligations.

A *rating of 4* indicates earnings that are seriously deficient. Trust and asset management activities have a significant adverse effect on the overall income of the institution and its ability to generate adequate capital to support the continued operation of these activities. Trust and asset management earnings that are poor historically or face the prospect of significant losses in the future characterize the institution. Management processes for monitoring and evaluating earnings are poor. The board of directors has not adopted appropriate measures to address significant deficiencies.

A *rating of 5* indicates critically deficient earnings. In general, an institution with this rating is experiencing losses from trust and asset management activities that have a significant negative impact on the overall institution, representing a distinct threat to its viability through the erosion of its capital. The board of directors has not implemented effective actions to address the situation.

Alternate Rating of Earnings

Alternate ratings are assigned based on the level of implementation of four minimum standards by the board of directors and management. These standards are:

- *Standard No. 1* - The institution has reasonable methods for measuring income and expense commensurate with the volume and nature of trust and asset management activities.
- *Standard No. 2* - The level of profitability is reported to the board of directors, or a committee thereof, at least annually.
- *Standard No. 3* - The board of directors periodically determines that the continued offering of trust and asset management activities being offered provide an essential service to the institution's customers or to the local community.
- *Standard No. 4* - The board of directors, or a committee thereof, reviews the justification for the institution to continue to engage in trust and asset management activities even if the institution does not earn sufficient income to cover the expenses of providing those services.

A *rating of 1* may be assigned where an institution has implemented all four minimum standards. If trust and asset management earnings are lacking, management views this as a cost of doing business as a full service institution and believes that the negative effects of not offering trust and asset management activities are more significant than the net loss experienced by engaging in these activities.

A *rating of 2* may be assigned where an institution has implemented, at a minimum, at least three of the four standards. This rating may be assigned if the institution has not yet begun generating positive earnings or where formal earnings information may not be available.

A *rating of 3* may be assigned if the institution has implemented at least two of the four standards. While management may have attempted to identify and quantify other revenue to be earned by offering trust and asset management services, it has decided that these services should continue to be offered, even if they cannot be operated profitably.

A *rating of 4* may be assigned if the institution has implemented only one of the four standards. Management has undertaken little or no effort to identify or quantify the advantages, if any, to the institution from engaging in trust and asset management activities.

A *rating of 5* may be assigned if the institution has implemented none of the standards.

Compliance

This rating reflects an institution's overall compliance with applicable law, accepted standards of fiduciary conduct, duties associated with account administration, internally established policies and procedures, as well as OTS policies. This component specifically incorporates an assessment of a fiduciary's compliance with applicable law and accepted standards of fiduciary conduct related to self-dealing and other conflicts of interest. The compliance component includes reviewing and evaluating the adequacy and soundness of adopted policies, procedures and practices generally, and as they relate to specific transactions and accounts. It also includes reviewing policies, procedures and practices to evaluate the sensitivity of management and the board of directors to identify and manage conflicts of interest. Risks associated with account administration are potentially unlimited because each account is a separate contractual relationship that contains specific obligations. Risks associated with account administration include: failure to comply with applicable law; inadequate account administration practices; inexperienced management; or inadequately trained staff. Risks associated with a fiduciary's duty of undivided loyalty generally stem from engaging in self-dealing or other conflict of interest transactions. An institution may be exposed to compliance, strategic, financial or reputation risk related to account administration and conflicts of interest activities. The ability of management to identify and control these risks is reflected in this rating. Policies, procedures and practices pertaining to account administration are evaluated in light of the size and character of an institution's trust and asset management business. The compliance rating is based upon, but not limited to, an assessment of the following evaluation factors:

- compliance with applicable federal and state statutes and regulations, including, but not limited to, federal and state trust and fiduciary laws; the Employee Retirement Income Security Act of 1974; federal and state securities laws; the Internal Revenue Code of 1986 and OTS policies;
- compliance with the terms of governing instruments;
- the adequacy of overall policies, practices and procedures governing compliance, considering the size, complexity and risk profile of the institution's trust and asset management activities;
- the adequacy of policies and procedures addressing account administration;
- the adequacy of policies and procedures addressing conflicts of interest;
- the adequacy of policies and procedures designed to prevent the improper use of "material inside information";
- the adequacy of securities trading policies and practices relating to the allocation of brokerage business, the payment of services with "soft dollars" and the combining, crossing and timing of trades;
- the decision making process used to accept, review and terminate accounts; and
- the decision making process related to account administration duties, including cash balances, overdrafts and discretionary distributions.

A *rating of 1* indicates strong compliance policies, procedures and practices. Policies and procedures covering conflicts of interest and account administration are appropriate in relation to the size and complexity of the institution's trust and asset management activities. Accounts are administered in accordance with applicable law, fiduciary principles and internal policies and procedures. Any violations are isolated, technical in nature and easily correctable. All significant risks are consistently and effectively identified, measured, monitored and controlled.

A *rating of 2* indicates fundamentally sound compliance policies, procedures and practices in relation to the size and complexity of the institution's trust and asset management activities. Account administration may be flawed by moderate weaknesses in policies, procedures and/or practices. Management's practices indicate a determination to identify and manage conflicts of interest. Trust and asset management activities are conducted in substantial compliance with applicable law and fiduciary principles and any violations are generally technical in nature. Management corrects violations in a timely manner and without loss to trust and asset management accounts. Significant risks are effectively identified, measured, monitored and controlled.

A *rating of 3* indicates compliance practices that are less than satisfactory in relation to the size and complexity of the institution's trust and asset management activities. Policies, procedures and practices have not proven effective and require strengthening. Trust and asset management activities may be in substantial noncompliance with applicable law and fiduciary principles but losses are no worse than minimal. While management may have the ability to achieve compliance, the number of violations that exist and/or the failure to correct prior violations, are indications that management has not devoted sufficient time and attention to its compliance responsibilities. Risk management practices generally need improvement.

A *rating of 4* indicates an institution with deficient compliance practices in relation to the size and complexity of its trust and asset management activities. Account administration is notably deficient. The institution makes little or no effort to minimize potential conflicts or refrain from self-dealing and is confronted with a considerable number of potential or actual conflicts. Numerous substantive and technical violations of applicable law and fiduciary principles exist and many may remain uncorrected from previous examinations. Management has not exerted sufficient effort to effect compliance and may lack the ability to effectively engage in trust and asset management activities. The level of compliance problems is significant and, if left unchecked, may subject the institution to monetary losses or reputation risk. Risks are inadequately identified, measured, monitored and controlled.

A *rating of 5* indicates critically deficient compliance practices. Account administration is critically deficient or incompetent. There are repeated violations of applicable law and significant departures from fiduciary principles. Management is unwilling or unable to operate in accordance with its responsibilities and efforts to obtain voluntary compliance have been unsuccessful. The severity of noncompliance presents an imminent monetary threat to trust and asset management accounts and creates significant legal and financial exposure to the institution. Problems and significant risks are inadequately identified, measured, monitored and/or controlled and now threaten the ability of management to continue engaging in trust and asset management activities.

Asset Management

This rating reflects the risks associated with managing the assets (including cash) of others. Prudent portfolio management is based on an assessment of the needs and objectives of each account for which the institution has investment discretion. An evaluation of asset management should consider the adequacy of processes related to the investment of all discretionary accounts, common and collective investment funds, proprietary mutual funds and other investment vehicles. The institution's asset management duties in regards to its trust and asset management accounts subject it to reputation, compliance and strategic risks. In addition, each individual account or portfolio managed by the institution is subject to financial risks such as market, credit, liquidity and interest rate risk, as well as transaction and compliance risk. The ability of management to identify and control these risks is reflected in this rating. The asset management rating is based upon, but not limited to, an assessment of the following evaluation factors:

- the adequacy of overall policies, practices and procedures governing asset management, considering the size, complexity and risk profile of the institution's discretionary accounts;
- the decision-making processes used for selection, retention and preservation of discretionary account investments including adequacy of documentation, committee review and approval, and a system to review and approve exceptions;
- the use of quantitative tools to measure the various financial risks in investment account portfolios;
- the existence of policies and procedures addressing the use of derivatives or other complex investment products;
- the adequacy of procedures related to the purchase and retention of miscellaneous assets including real estate, closely held companies, limited partnerships, mineral interests and other unique assets;
- the extent and adequacy of periodic reviews of investment performance, taking into consideration the needs and objectives of each account;
- the monitoring of changes in the composition of discretionary fiduciary assets for trends and related risk exposure;
- the quality of investment research used in the decision-making process and documentation of the research;
- the due diligence process for evaluating investment advice received from vendors and/or brokers (including approved or focus lists of securities); and
- the due diligence process for reviewing and approving brokers and/or counter parties used by the institution.

This rating may not be applicable for some institutions because their operations do not include activities involving the management of any discretionary assets. Activities of this type would include, but not necessarily be limited to, directed agency relationships, securities clearing, transfer agent or securities registrar activities. In institutions that do not have any discretionary assets, the examiner in charge may omit the rating for asset management. However, this component should be assigned when the institution provides investment advice, even though it does not have discretion over the account assets.

A rating of 1 indicates strong asset management practices. Identified weaknesses are minor in nature. Risk exposure is modest in relation to management's abilities and the size and complexity of the assets managed.

A rating of 2 indicates satisfactory asset management practices. Moderate weaknesses are present and are well within management's ability and willingness to correct. Risk exposure is commensurate with management's abilities and the size and complexity of the assets managed.

A rating of 3 indicates that asset management practices are less than satisfactory in relation to the size and complexity of the assets managed. Weaknesses may range from moderate to severe; however, they are not of such significance as to generally pose a threat to the interests of the trust and asset management accounts. Asset management and risk management practices generally need to be improved. An elevated level of supervision is normally required.

A rating of 4 indicates deficient asset management practices in relation to the size and complexity of the assets managed. The levels of risk are significant and inadequately controlled. The problems pose a threat to

the trust and asset management accounts generally, and if left unchecked, may subject the institution to losses and could undermine the reputation of the institution.

A *rating of 5* represents critically deficient asset management practices. These practices jeopardize the interests of the trust and asset management accounts, subject the institution to losses and may pose a threat to the soundness of the institution.

CHAPTER: Examination Administration

SECTION: Post Examination Activities

Section 070

Introduction

This section discusses post examination activities that are essential to fulfilling the supervisory oversight of the savings association. Included in this section are the activities necessary to complete the examination process, the objective of the meetings with the board of directors or trust committee and the coordination with the Uniform Interagency Trust Rating System (UITRS). While these activities are a continuing part of the examination process, they are referred to here as post examination activities to distinguish them from the on-site portion of the examination.

On-Site and/or Post Examination Closing Procedures

For every trust and asset management examination conducted by the Office of Thrift Supervision the following on-site and/or post examination closing procedures will be performed:

- Summarize the results and conclusions at the end of each examination program
- Review the workpapers and summary conclusion to ensure that the examination objectives have been achieved
- Ensure that there are properly cross-referenced workpapers to document and support substantive findings and conclusions
- Draft comments for the ROE, including the scope and recommendations
- Assign the Uniform Interagency Trust Ratings

Meetings with the Board of Directors

As stated in 12 CFR §550.150, the board of directors is responsible for the proper exercise of a savings association's trust powers. In addition, OTS emphasizes the essential role of each institution's board of directors in establishing the policies that result in safe and sound operations. Consistent with this philosophy is the belief that board members should be actively involved in the regulatory process.

Meetings between regulatory staff and the board of directors, the individuals ultimately responsible for a savings association's affairs, serve a variety of functions. They provide opportunity for interaction and they facilitate long-term communication, which is especially important when the regulatory process reveals significant adverse information. They help to keep the directors and regulators mutually informed by providing them an opportunity to discuss:

- the examination process and findings;
- the institution, its functions and plans;
- the external and competitive environment; and
- industry-related concerns.

The need for effective communication between examiners and the board of directors is of paramount importance when the regulatory process reveals significant adverse information, for example when the trust department receives a 3, 4, or 5 composite rating under the UITRS; as a result, meetings with the board of directors are strongly encouraged in these instances. Meetings with the board of directors are encouraged regardless of a department's condition, at least on a periodic basis.

Types of Meetings

There are two types of meetings, regular and special. Generally, examination-related matters are discussed at regular meetings and special meetings are held for purposes other than the specific presentation of examination findings. However, any meeting may serve more than one purpose; thus, the distinction between regular and special meetings may be an artificial one in some instances. For example, meetings called by regulatory staff to implement a formal enforcement action are often the direct result of examination findings, even though the meeting itself is not technically examination-related.

Regular Meetings - Regular meetings may result from regular, special or targeted examinations. The primary purpose of these meetings is to present and discuss examination findings and, if necessary, reach agreement on a plan of corrective action. A secondary purpose may be to gather information regarding a new product or service or future plans for the savings association. These meetings may also be used to enhance the directors' understanding of the regulatory process and to establish rapport and build lines of communication between regulators and directors. Examiners should meet with the board of directors of adversely rated institutions following the conclusion of the examination. Adversely rated institutions are defined as those with a UITRS composite rating of 4 or 5 and a UITRS composite rating of 3 if the rating represents a downgrade from the previous examination.

Generally, examiners should meet with the board of directors of all 3-rated institutions; however, the examiner-in-charge (EIC), with the concurrence of the regional office, has discretion to determine whether a meeting is necessary or appropriate in those cases in which the 3 rating is not a downgrade from the prior examination. Meetings with the board of directors on nonadversely rated institutions are also encouraged, especially if the EIC notes adverse trends, a risk profile that reflects an increase in risk or other matters that need to be brought to the board's attention. For nonadversely rated trust departments which are considered large and complex, meetings with the board or its trust committee are strongly encouraged, whether or not adverse trends are noted.

Regular meetings should normally be held subsequent to the examination, although they may be held during the last week of the examination if the examination results have already been discussed with senior management. They may also be held in conjunction with the next regularly scheduled board meeting, or to coincide with other meetings scheduled as a result of reasonably concurrent examinations, such as safety and soundness or compliance examinations, or at some other mutually agreed upon date. Whenever possible, it should be no later than 60 days after the completion of the examination. When scheduling the meeting, regulators should make every effort to ensure that the board of directors is familiar with the examination findings or has received a copy of the trust and asset management examination report prior to the meeting.

The following issues, while not all-inclusive, would warrant the board of director's attention and therefore should be considered for inclusion in the meeting agenda:

- a comparison of the savings association's policies, practices and reporting systems with those one would expect to find in a well-managed institution of comparable size and offering similar services;
- senior management's efforts to correct deficiencies in policies, practices and reporting systems;

-
- the department's system of internal controls, including the risk management, compliance and audit programs;
 - the extent to which senior management and directors are receiving information needed to manage or oversee the affairs of the department effectively;
 - depth in management personnel;
 - any significant concerns or observations regarding the quality of earnings;
 - management's long term plans; and
 - the board's involvement in the department's affairs.

OTS examiners should be prepared to discuss possible methods for achieving correction of any deficiencies noted. However, it is important for the examiners to refrain from managing the department by directing the specific course of action that is to be taken. If no major deficiencies are noted, examiners can inform the board of directors of the general condition of the trust department and obtain the board's view on its operation in the future. The directors should be encouraged to discuss any matters of interest.

The meetings are expected to foster a working relationship with those individuals who are directly responsible for the management of the trust department. Meetings must be constructive and conducted in a clear, concise and orderly manner, accompanied by a written agenda presented to the attendees. Success depends entirely on the substance of matters discussed and the effort expended to prepare for the meeting.

Special Meetings - Meetings with the board may be required to facilitate other goals apart from presenting the findings of a report of examination. For example, a special meeting would be appropriate to institute a supervisory action, to gather information in order to act on a specific proposal, application or request by the institution, or to discuss an institution's progress in achieving interim goals in accordance with a corrective action plan. In addition, get-acquainted meetings may also be held as a special meeting, perhaps caused by a change in the composition of the board of directors or a change of examiners assigned to the savings association. Finally, special meetings may be held as a result of a request to meet with OTS staff.

Composite Trust Rating System and Post Examination Follow-up

The frequency schedule for the conduct of regular trust and asset management examinations is in large measure dependent upon the composite rating assigned to a department under the UITRS. The need for follow-up contact with a savings association may be satisfied by the post examination meeting between OTS regulatory staff and the board of directors, as well as periodic monitoring and communication with management.

For a department that receives a composite 3, 4, or 5 rating, the level of follow-up activity will vary according to the severity of the problems noted, the corresponding enforcement action taken and the institution's history of responsiveness to supervisory actions, both generally and in terms of its trust department. The following guidelines are designed to provide a framework under the UITRS for the application of reasonably uniform follow-up procedures on a national basis. However, because follow-up activity must be tailored to the circumstances of each individual institution and its trust department, these guidelines are not intended to preclude flexibility and judgment to design and apply other remedial and supervisory measures.

Trust Departments Rated 1 or 2 - Corrective action for a department rated composite 1 or 2 would normally be taken or initiated during the on-site examination. Any weaknesses not resolved during the

examination should be addressed by management in its response to the examination report in sufficient detail so as to allow the regional office to conclude that the matters have been or will be appropriately resolved. However, if a significant change in its operations or other significant developments has occurred between examinations, then a targeted examination or other type of visitation to review the changes should be considered.

Trust Departments Rated 3 - If a department receives a composite 3 rating, its trust and asset management activities exhibit some supervisory concern. A combination of weaknesses exist that may range from moderate to severe. Therefore, the savings association's trust and asset management activities will require more than normal supervision and may include informal or formal enforcement actions. For example, if compliance problems or other important weaknesses remain largely uncorrected from one examination to the next or if overall performance has significantly deteriorated between examinations, then a more forceful supervisory response is necessary in order to effect correction or to forestall any further deterioration. In these situations, normal follow-up procedures should be supplemented by a meeting with the full board of directors and the use of an informal or formal action should be considered. Also, a targeted examination should be scheduled if regional office management believes that on-site verification of corrective action is deemed prudent. Formal supervisory action, such as a cease and desist order, should be taken where there are repeated substantive violations of laws and regulations.

Trust Departments Rated 4 - If a department receives a composite 4 rating; serious questions are raised about its ability to discharge its trust and asset management responsibilities. Performance at this level poses a threat to trust and asset management accounts and, if left unchecked, could evolve into conditions that could ultimately undermine public confidence in the savings association. Therefore, a department receiving a composite 4 rating requires close supervisory attention. A meeting with the full board of directors is required and targeted examinations should be conducted to properly monitor the department's condition. In most instances, the use of a formal enforcement action is necessary to address the problems.

Trust Departments Rated 5 - If a department receives a composite 5 rating; its performance poses a serious threat to the safety and soundness of the savings association. Such a department requires immediate and close supervision. Targeted examinations should be conducted. Formal supervisory action and, depending on the circumstances, the use of regulatory sanctions and/or termination of the savings association's trust powers would normally be required.

CHAPTER: Examination Administration

SECTION: Enforcement Activities

Section 080

Introduction¹

It is the policy of the Office of Thrift Supervision (OTS) to fully use its statutory authority to take prompt and vigorous enforcement action where warranted to ensure the safety and soundness of thrift institutions. Proper use of OTS's formal enforcement powers as well as informal supervisory responses is critical in helping OTS meet its responsibilities to: ensure the safety and soundness of the thrift industry; ensure that thrifts comply with applicable law and fiduciary principles; maintain the soundness of the Savings Association Insurance Fund (SAIF); and protect consumers. To enforce its powers, OTS may take action against a thrift, its holding company, affiliates, service corporations or operating subsidiaries. At a minimum, an institution with a composite rating of 4 or 5 in its last trust and asset management examination is presumed to warrant formal enforcement action unless the regional director documents that the problems are satisfactorily corrected or in the process of full correction.

Regulators have available to them a number of informal responses to violations of applicable law and/or unsafe or unsound practices. Those actions include, but are not limited to:

- Meetings with management;
- Meetings with boards of directors;
- Supervisory letters and directives;
- Special examinations; and
- Requests for voluntary management changes or reorganizations.

The OTS office of enforcement (OE) and regional litigation and enforcement counsel, working closely with the referring regional or area office, will initiate and direct formal enforcement actions.

Formal response powers include:

- Supervisory agreements;
- Consent merger agreements;
- Cease-and-desist orders (C&Ds);
- Temporary C&Ds;
- Injunctive actions;
- Removal and/or prohibition orders;
- Immediate suspensions during removal and prohibition proceedings;
- Temporary suspensions for certain criminal indictments;

¹ This section is substantially an adaptation of Section 370 of the Thrift Activities Handbook. Certain items have been deleted to focus more on enforcement issues arising in connection with trust and asset management examinations. Trust and asset management examiners should follow the examination procedures in Section 370 of the Thrift Activities Handbook when proceeding with enforcement action recommendations.

- Temporary suspension of insurance;
- Termination of insurance²;
- Civil money penalties;
- Capital directives;
- Capital plans (temporary operating restrictions);
- Individual Minimum Capital Requirement (IMCR) directives;
- Prompt Corrective Action (PCA) directives; and
- Conservatorships and receiverships.

In addition, OTS has authority to conduct formal examinations, commonly referred to as investigations that include the powers to: (1) issue subpoenas that are enforceable in the United States District Court and (2) take sworn testimony.

When to Use Enforcement Actions

OTS uses its enforcement powers primarily to halt unlawful acts or practices and to require corrective action. Also, in the case of civil money penalty assessments, enforcement powers are used as a strong deterrent to violations of applicable law, orders, breaches of fiduciary duty and/or unsafe or unsound practices. The following are discussions of the more frequently used enforcement actions, OTS's administrative hearing process and OTS's informal action authority.

Orders to Cease and Desist

A C&D order normally requires a halt to illegal, unsafe or unsound activities. An order may also require affirmative corrective action, including, for example, the adoption of new policies and procedures, filing special reports, rescinding prior transactions or making restitution.

OTS has the authority to issue a C&D if it is of the opinion that one of the following factors is present: an unsafe or unsound practice or a violation of applicable law; any condition imposed in writing in connection with the granting of an application; or any written agreement with OTS or the Federal Deposit Insurance Corporation (FDIC). An order may also be issued if OTS has reasonable cause to believe that such a practice or violation will occur. The statutory basis for issuing C&Ds is in the Federal Deposit Insurance Act (FDIA), 12 USC §1818(b).

Historically, the types of violations most likely to be remedied by C&Ds include: failure to maintain adequate books and records, deficient appraisal reports, transactions involving conflicts of interest and improper accounting. C&Ds may also be used in the trust and asset management area in response to violations of applicable law or fiduciary principles. Thrift regulators are urged to use C&D authority promptly to remedy any potentially unsafe or unsound situation that could threaten the integrity or viability of an institution.

C&Ds are issued either with the consent of the party named in the order or after the conclusion of a hearing, initiated by OTS serving a notice of charges on the institution or individual.

² Termination of insurance accounts is an action taken by the FDIC but may be recommended by the OTS.

C&Ds can be issued against a savings association or an institution-affiliated party³. C&Ds may also be issued against an affiliate service corporation, savings and loan holding company or holding company subsidiary.

Violations of C&Ds

If an institution or individual fails to comply with a final order, OTS or FDIC may seek enforcement through federal district court. The court's jurisdiction is limited to ordering the enforcement of and compliance with effective and outstanding orders. (An institution or an individual may challenge the merits of a C&D in an appropriate federal court of appeals.)

In addition, any savings association or individual that violates the terms of any final C&D can be ordered by OTS to pay a civil money penalty of up to \$1,000,000 a day for each day the violation continues, provided that specific statutory criteria are met.

Temporary C&Ds

In situations requiring immediate action, thrift regulators use temporary C&Ds. To issue a temporary order, OTS or FDIC must also issue a notice of charges initiating a proceeding to obtain a permanent C&D. It must also determine that the violation, unsafe or unsound practice or threatened violation or practice charged in the notice is likely to: (1) cause insolvency or significant dissipation of assets; (2) weaken the institutions' condition; or (3) prejudice the interests of its depositors prior to the completion of the C&D proceeding. (Certain additional determinations are necessary if the purpose of the temporary C&D is to prevent an institution-affiliated party from dissipating or otherwise disposing of assets.) A temporary C&D may order affirmative action to prevent such insolvency, dissipation, condition or prejudice pending the completion of the C&D proceedings. In addition, if OTS determines that an insured depository institution's books and records are so incomplete or inaccurate that OTS is unable, through the normal supervisory process, to determine the financial condition of the institution or the details of a transaction that may have a material effect on the financial condition of the institution, it can issue a temporary C&D requiring: (1) the cessation of any activity or practice that gave rise to the incomplete or inaccurate books or records or (2) affirmative action to restore the books and records to a complete and accurate state, until the completion of the proceeding initiated by the notice of charges.

³ 12 U.S.C. §1813(u)

The term "institution-affiliated party" means:

- a. Any director, officer, employee, or controlling stockholder (other than a savings and loan holding company) of, or agent for, an insured depository institution;
- b. Any other person who has filed or is required to file a change-in-control notice with OTS under 12 USC § 1817(j);
- c. Any shareholder (other than a savings and loan holding company), consultant, joint venture partner or any other person as determined by OTS (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution; and
- d. Any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in:
 1. Any violation of any law or regulation;
 2. Any breach of fiduciary duty; or
 3. Any unsafe or unsound practice

which caused or is likely to cause more than a minimal financial loss to, or have a significant adverse effect on, the insured depository institution.

After a temporary C&D is issued, an institution or individual has ten days to apply to the federal district court to set aside, limit or suspend the order. The court is guided by traditional tests for determining whether to enjoin an agency order. Though the standard varies slightly from circuit to circuit, generally the applicant for an injunction must show the court that there is a substantial likelihood of success on the merits and that irreparable harm would flow from denial of the request for relief. The court also considers the public interest and the harm to the agency from the injunction.

If a temporary C&D is violated, OTS may apply to a district court for enforcement. If the court determines that a violation, threatened violation or failure to obey has occurred, by law the court must enforce the order. A temporary C&D terminates automatically when the charges in the notice initiating the proceeding for the permanent C&D are dismissed by the agency or when a permanent C&D against the same party becomes effective.

Orders of Removal and Prohibition

In appropriate circumstances, a removal and/or a prohibition order may be issued, depending upon the role of the individuals who are the subjects of the order. Officers and directors may be removed from office and prohibited from further participation in the institution's affairs. Persons, who participate in the affairs of an institution but hold no office, including former officers and directors, may be simply prohibited from further participation.

A discussion of OTS's grounds for issuing orders for removal and prohibition follows. The grounds are identical for both state- and federally chartered institutions. 12 USC §1818(e).

Institution-Affiliated Parties

Under the FDIA, an institution-affiliated party can be removed from office and prohibited from further participation in an institution's affairs if:

- The institution-affiliated party directly or indirectly has: (1) committed any violation of a law, regulation or final C&D; (2) violated any condition imposed in writing by the appropriate federal banking agency in connection with the grant of any application or other request by the depository institution; (3) violated any written agreement between the depository institution and the agency; (4) engaged or participated in any unsafe or unsound practice with respect to any insured depository institution or business institution; or (5) committed or engaged in any act, omission or practice that constitutes a breach of such party's fiduciary duty;
- As a result of the violation, unsafe or unsound practice, or breach of fiduciary duty described above: (1) the insured depository institution or business institution has suffered or will probably suffer financial loss or other damage; (2) the interests of the insured depository institution's depositors have been or could be prejudiced; or (3) such party has received financial gain or other benefit from such violation, practice, or breach; and
- The violation, unsafe or unsound practice, or breach of fiduciary duty: (1) involves personal dishonesty or (2) demonstrates a willful or continuing disregard for the safety or soundness of the insured depository institution or business institution.

Temporary Suspensions

An order temporarily suspending an individual from a position may be issued only in conjunction with a notice of intention to remove or prohibit which commences a formal adjudicatory proceeding. By statute, OTS can issue a temporary suspension only if the suspension is necessary to protect the interests of the depository institution or its depositors. The suspension remains in effect pending the removal or prohibition proceeding initiated by the notice, unless it is stayed by a district court as provided by the FDIA 12 USC §1818(e)(3)(A).

The subject of the temporary suspension may apply to the district court, within ten days of service of the suspension, for an injunction or stay of the suspension. The court will consider both the reasonableness of OTS's decision to issue the suspension and the traditional standards for injunctive relief. Because OTS will have only a short time to respond to any application for relief, it must have in hand documentation of the violation or unsound practices. This documentation should be presented to OTS (regional office and in Washington) for its consideration at the time of OTS enforcement counsel's request for the suspension. It may be used to demonstrate the reasonableness of OTS's action to a reviewing court. Examination reports or other materials documenting a decline in an institution's financial violations of applicable law or personal gain of any individual, are particularly helpful. If a formal examination (see discussion below) has been conducted, excerpts from testimony implicating the respondent in illegal or unsound activities should be included in the package to OTS.

Supervisory Agreements

Supervisory agreements may address any applicable law violation or unsafe or unsound practice by an institution or institution-affiliated party. Supervisory agreements may require the cessation of any statutory or regulatory violation or unsafe or unsound practice. They may require affirmative corrective action to address any existing violations, management or operational deficiencies or other unsound practices. In short, they may include the same broad range of provisions that may be incorporated into C&D orders.

Regional directors and their designees have the authority to negotiate and execute supervisory agreements and they should determine whether an insured institution's problems are serious enough to warrant a supervisory agreement or, instead, can be adequately addressed by a board of directors' resolution, supervisory meeting or correspondence. The decision to obtain a supervisory agreement should be based on:

- an analysis of the facts;
- the institution's supervisory history;
- the type of management involved;
- the results of a meeting with the board of directors;
- an evaluation of whether management will take appropriate corrective action;
- an assessment of the potential harm to the institution if corrective action is not effected;
- an assessment of whether a matter is so serious that it warrants more formal action than a supervisory agreement; and
- the OTS's general policy guidelines on enforcement actions (Table 1).

Under the FDIA, the OTS may initiate C&D proceedings for violations of its written agreements. To clarify that supervisory agreements are enforceable by C&D action, each one explicitly states that it is an “agreement with OTS.” Violations of supervisory agreements (unlike C&Ds) do not form the basis for court enforcement. However, such violations do form the basis for the possible assessment of civil money penalties, C&D actions and removal or prohibition actions.

Table 1	
Considerations for Determining Whether Enforcement Action is Warranted:	
Among the factors to consider when determining whether certain illegal, unsafe or unsound conduct warrants the use of formal enforcement action or an informal supervisory response are the following:	
1.	The extent of actual or potential damage, harm, or loss to the thrift institution as a result of the action or inaction;
2.	Whether the illegal action or unsafe or unsound practices has been repeated;
3.	The likelihood that the conduct may occur again;
4.	The institution's record for taking remedial or corrective action in the past;
5.	The extent to which the identified problems were preventable and not solely the result of external factors;
6.	The effect of the illegal or unsafe or unsound conduct on other institutions;
7.	The examination rating of the institution;
8.	Whether the agency's objective has been or is likely to be achieved because of action taken or contemplated by other government agencies or private litigation; and
9.	The presence of unique circumstances.

When considering a supervisory agreement with a state-chartered institution, OTS regulators should consult with the state supervisor and solicit concurrence.

Civil Money Penalties

OTS possesses statutory authority under the FDIA and other statutes to assess civil money penalties against savings associations, their service corporations or operating subsidiaries, savings and loan holding companies and institution-affiliated parties for: (1) violations of any law or regulation; (2) violations of the terms of any final order or temporary order issued pursuant to Section 902 of FIRREA; (3) violations of any condition imposed in writing by OTS in connection with the granting of any application or other request by the association; (4) violations of any written agreement between the association and OTS; (5) breaches of fiduciary duty; and (6) unsafe or unsound practices. OTS may also assess civil money penalties for failing to maintain adequate records, for failing to file, or filing late or inaccurate OTS-required reports.

The assessment of a civil money penalty provides a strong deterrent to violations of applicable law, OTS orders, breaches of fiduciary duty and unsafe or unsound practices.

When assessing a civil money penalty, consideration should be given to the size of financial resources and good faith of the person, association or company being assessed; the gravity of the violation; the history of previous violations; and such other matters as justice may require. OTS uses the civil money penalty form as

guidance in considering and assessing civil money penalties. The form consists of a civil money penalty tier matrix that is used to determine the tier of a violation and a civil money penalty calculation sheet that is used to assess a penalty amount for the violation. Two tier matrices have been prepared: a general tier matrix and a reporting violation tier matrix. A tier matrix (if applicable to the violation) and calculation sheet should be completed before any penalty is assessed.

While these matrices are expected to be used in all cases where an assessment is being considered, they are not substitutes for sound supervisory judgment. Individual cases may possess particularly egregious or mitigating characteristics that have not been included as factors in the matrices.

For more detailed information on the application of civil money penalties, refer to Regulatory Bulletin (RB) 18-3a, "Enforcement Policy Statement on Civil Money Penalties," dated July 30, 1993.

Openness of Administrative Proceedings

OTS institutes administrative proceedings pursuant to the FDIA in order to obtain enforcement orders. Federal banking agencies conduct public hearings on the record for any notice of charges issued, unless holding a public hearing would be contrary to the public interest. A transcript that includes all testimony and other documentary evidence given or submitted during these hearings must be prepared and made available to the public.

Consent Orders

Prior to the initiation of an investigation or formal examination, a regional director may, with the concurrence of the deputy chief counsel for enforcement, enter into any consent orders providing for a C&D, removal or prohibition, civil money penalty or professional disciplinary relief. In each instance, a determination shall be made whether the facts of the case warrant a demand for restitution or other affirmative corrective action. All consent orders that involve unresolved legal or policy issues, raise matters of special significance or sensitivity for the agency or involve total amounts of \$100,000 or more for restitution, civil money penalties or other affirmative corrective relief shall require the prior concurrence of the director of examination policy and chief counsel.

Formal Enforcement and Investigative Authority

Generally, OTS expects its examiners and supervisors to exhaust informal means of obtaining information before requesting a formal investigation. OTS staff should seek and use reliable information from savings associations and their affiliates, employees, agents, and such outside sources as borrowers, joint venturers, county land record offices and other government authorities.

When informal avenues have been exhausted, formal investigations can serve several objectives, including: (1) enhance regular examinations when necessary to compel uncooperative sources to produce documents or statements and (2) enhance special examinations where subpoena power is necessary to determine whether enforcement action is warranted.

OTS has broad authority to conduct examinations under HOLA and FDIA, particularly when conducting formal investigations. The OTS may take testimony under oath and issue subpoenas and subpoena *duces tecum* to any person on any matter related to the affairs of ownership of savings associations and their affiliates, and enforce such subpoenas in United States District Courts. Generally, the courts will compel

compliance with investigative subpoenas if the information sought is relevant to the inquiry or is likely to lead to the discovery of relevant information.

The result of this investigative authority (the power to issue subpoenas for documents and sworn statements) is a valuable tool for OTS in carrying out its examining, supervisory and enforcement responsibilities.

The discussion below with respect to HOLA and FDIA investigations applies also to investigations and examinations related to a thrift's holding company, subsidiaries and affiliates.

Initiation of a Formal Investigation Proceeding

A formal examination or investigation may be initiated upon the recommendation of the deputy chief counsel for enforcement and the appropriate regional director with the concurrence of chief counsel and the director of examination policy. The documents supporting the request for an investigation are drafted by the legal department and should include a short summary of the facts giving rise to the investigation.

Within two weeks of initiation of the investigation, a written plan of investigation should be provided to chief counsel. The plan should be developed in consultation with the appropriate OTS staff and should identify the major investigative steps contemplated. The plan should call for the completion of the investigation within timeframes and other guidelines established by chief counsel. Such timeframes and guidelines are for administrative purposes only and do not affect the authority of the staff to continue to conduct such investigations or the obligation of any party to respond to subpoenas for testimony or production of documents.

A formal investigation proceeding is an extension of the examination process, although it may not always be accompanied or immediately preceded by an examination. It enables the OTS to obtain access to information (in the form of subpoenaed documents or sworn testimony) that it has not obtained through the usual means of information gathering, e.g., the examination process and other requests by examiners and regional directors, for information. An investigation is a means to obtain information that is otherwise unavailable. OTS has determined, as a matter of policy, to shift the emphasis to "field" investigations, as a means of obtaining information either within or outside the association prior to considering the use of its formal investigative authority.

Subpoenas are not necessary to compel the production of the records of savings associations or their affiliates as OTS has the authority to examine these records. Informal requests by examiners to interview persons outside the association or to review records of a borrower or other entity that is not a savings association or an affiliate often can achieve the same effect. Information may also be obtained from publicly available sources of information, such as land records or state corporation commissions. Sufficient information may be received in these interviews and from document requests either to make an investigation unnecessary or, if still necessary, to enable the investigations to be limited in scope. Regulatory staff contemplating a request that an investigation be authorized should consider the advantages and timing of formal or informal approaches to obtaining information. The merits of each approach should be discussed with regional counsel.

OTS's investigative powers may not be used to conduct a criminal investigation or to gather documents for the purpose of making a criminal referral. OTS's investigative powers are civil and administrative in nature and are designed for use in carrying out OTS's examining, supervisory, regulatory and enforcement responsibilities. However, when information obtained for an authorized civil purpose is sufficient to provide a reasonable factual basis for a belief that a crime has been or may have been committed and no Suspicious

Activity Report (SAR), or an inadequate SAR has been filed by a savings association with FinCEN, OTS personnel will file using the OTS's Form 1601. In this regard, special units in each OTS regional office perform a critical function in making referrals, providing assistance to criminal investigators and prosecutors in areas within their specialized knowledge, providing a liaison between OTS and the criminal authorities, and at times serving as agents of the grand jury.

Pursuant to 5(d)(1)(B) of the HOLA as amended by FIRREA, an examiner is entitled to prompt and complete access to all savings association personnel and agents and to all documents. Any refusal to supply records or otherwise to obstruct the progress of an OTS examination should be brought to the attention of the OTS enforcement division. Section 5(d)(1)(B) grants the OTS specific authority to go to federal court to obtain an order requiring that such access be provided.

Types of Investigations

An investigation can be initiated to accomplish a number of different objectives. These objectives will guide the conduct and direction of the investigation. Some formal examinations are initiated simply to supplement an ongoing regular examination by subpoenaing records outside the control of the savings association being examined. The role of enforcement counsel in this type of investigation generally is to prepare the package of information needed to base a decision on whether to initiate the investigation, to draft the necessary subpoena(s) and to respond to inquiries from counsel for the recipient(s) of the subpoenas. The actual review of documents and requests for additional information needed to complete the examination is typically made by the examiners following consultation with legal staff, although on occasion legal staff may review the information directly. The results of these formal examinations may be incorporated into the regular examination report and depending on their nature may end the investigation or result in further formal enforcement inquiry or action. Requests for this type of formal examination should be made immediately after an examiner has been denied access to information that is believed necessary to properly complete the examination; such requests should not be delayed until the regular exam is completed.

Another use of an investigation is to expand the scope of an inquiry initiated during a regular examination to uncover facts needed to determine whether other formal enforcement action should be recommended or initiated. Generally this type of investigation concerns matters that, if the results of the investigation so warrant, could result in initiation of a C&D order, removal and prohibition proceeding or a securities/control case. These investigations involve the active participation of enforcement counsel in conjunction with examination and supervision personnel. Such investigations usually involve the issuance of subpoenas for documents and for sworn testimony. Depending on the information discovered in these investigations, formal or informal enforcement action may be initiated, a criminal referral prepared or a conservatorship or receivership recommended. Investigations also may be conducted to prepare for administrative or civil litigation.

Interviews, Information Requests, and Subpoenas

The most common means of conducting an investigation are by interview or document request. These can be accomplished voluntarily or by compulsion through the issuance of a subpoena. While HOLA and FDIA authority is not needed to interview a witness, interviews will sometimes be conducted in preference to sworn statements under the following circumstances: (1) when it is not believed necessary to record the information sought or the witness' views of that information; (2) where the witness is cooperative; (3) when the information is of a preliminary nature; or (4) when it must be collected very quickly. Conversely, sworn recorded testimony will be favored: (1) when the testimony is anticipated to be central to the investigation; (2) when it is desired that the witness be placed under oath and be bound by his or her statement; or (3) when

the investigator is concerned that the complexity of the information is such that it would not be fully understood unless recorded and reviewed.

Role of Regional Offices in Formal Investigations

A close working relationship between examiners and OTS legal staff is critical in investigations involving allegations of unsafe or unsound practices or violations of fiduciary practices or applicable law. The examiner's participation is vital both in reviewing subpoenaed documents and in identifying and pursuing areas for further inquiry. In those investigations in which examiners are to review the documents subpoenaed or attend the taking of sworn statements, it is imperative that their time be scheduled to accommodate this additional workload.

The use of investigative powers is a powerful government tool that must be used with experience, sensitivity and care. For this reason, experienced legal staff work together with examiners and supervisory personnel in conducting investigations. If they desire, examiners and supervisory personnel experienced in formal enforcement matters may question witnesses along with attorneys during the taking of sworn statements.

When an investigation is ongoing, the OTS attorney directing the investigation shall keep supervisory staff closely informed of all events pertaining to the investigation. Similarly, the supervisory staff will consult with the assigned attorney before sending the association nonroutine supervisory letters, directives, agreements, or other supervisory correspondence that could have an effect on the investigation or on possible enforcement proceedings. OTS attorneys will respond immediately to any such inquiries so that supervisory correspondence will not be unreasonably delayed.

Procedures

In most cases, requests for authority to initiate an investigation are made by the regional office where the savings association is located. Requests for investigations relating to savings and loan holding companies and changes in control of a savings association frequently come from the CASD. In addition, the director of OTS or another OTS official may request an investigation as a result of information coming to his/her attention from other activities of the agency. Also, the office of enforcement may recommend an investigation with regional office concurrence.

The timing of a request for an investigation is a function, in part, of the reason the investigation was initiated. An examination report need not be in final form for an investigation to be started. As described hereafter, some investigations are conducted concurrently with a regular examination, while others are initiated after the examination and supervisory processes, in an effort to determine whether formal enforcement actions are necessary. Investigative authority may also be used for other appropriate fact-finding purposes.

Recommendations for investigations may be made in a short memo to regional enforcement counsel or to the enforcement division in Washington, D.C., containing the following information (to the extent available and known):

1. The name, address, and docket number of the savings association(s).
2. A brief description of facts causing the request (including reference to the provision violated, if known).
3. A brief description of the information sought in the investigation.

4. The purpose of the investigation (e.g., obtaining documents to complete a regular examination, obtaining sworn testimony about the relationship between an officer and a borrower, obtaining information to determine whether an enforcement action is necessary, etc.).
5. Whether the regional director wants the regional counsel to direct or to participate in the investigation and the names and titles of the OTS employees that will represent the OTS in the investigation.
6. The primary contact person at the regional office for communications with the office on enforcement concerning the investigation.

This list is not exhaustive. Appropriate enforcement action should be taken in any other situation in which it is determined such action is warranted.

The deputy chief counsel for enforcement promptly will concur or disagree with the proposed investigation and advise as to whether regional counsel or OTS enforcement will direct the proposed inquiry.

Furthermore, to facilitate the drafting and mailing of any subpoenas, examiners who are going to be involved in the investigation should, as early as possible, prepare accurate lists of persons and entities on whom they recommend subpoenas be served. They should also include the mailing addresses for those persons and entities and a brief description of what documents or sworn testimony each person or entity might provide in the investigation.

Regulatory Considerations

Selecting the Appropriate Tool

It is the policy of OTS to fully use its statutory authorities to take prompt and vigorous enforcement action against thrift institutions, their directors, officers, agents, holding companies, service corporations or their officials where warranted to ensure the safety and soundness of such thrift institutions; the thrift industry in general; as well as to uphold applicable law. Also, as previously noted, it is OTS policy that, when the requirements of law have otherwise been satisfied, thrift institutions with a composite rating of 4 or 5 for the latest trust and asset management examination are presumed to warrant formal enforcement action unless the regional director documents that the problems are satisfactorily corrected or in the process of full correction.

Enforcement action against institutions should be promptly initiated regardless of examination ratings, when there is a basis to believe that:

1. There is serious insider abuse, even if the institution is not immediately or directly harmed.
2. The institution has committed a significant violation of applicable law.
3. An institution or any individual involved has disregarded or refused to respond to prior supervisory efforts to correct serious problems.
4. Any unsafe or unsound practice or any violation of conditions or agreements has occurred resulting in a significant risk or substantial loss.
5. A serious violation of the change in control act has occurred.

Choosing the appropriate supervisory or enforcement tool involves the careful balancing of factors and the exercise of discretion. Table 1 lists the general considerations for determining whether to use a formal enforcement action or an informal supervisory response.

Before taking or initiating formal action, it must be determined that the facts support the applicable statutory grounds for initiating the action. Allegations of misconduct that are raised in the examination, supervisory or enforcement processes must be supported with evidence of specific instances that would reasonably lead to the belief that such misconduct occurred or is likely to occur.

Of course, OTS will not permit the continuation of an illegal, unsafe or unsound conduct that is harmful or potentially harmful to an insured institution while regulators document all details. OTS expects regulators to use supervisory responses and enforcement actions in a timely and effective manner to protect insured institutions and, ultimately the insurance fund.

Checking for Compliance with Outstanding Agreements

The recurrence of a problem that has been addressed by an informal method of supervision, such as a supervisory agreement, raises a presumption that a C&D action or assessment of a civil money penalty should be pursued. A material violation of a supervisory agreement should cause a regulator to immediately consider pursuing a C&D action or assessing a civil money penalty unless there are substantial mitigating factors.

Therefore, it is essential that during every examination, regulators expressly check for compliance with each outstanding agreement or order. The terms of the agreement or order should dictate the scope of the inquiry. For example, an agreement requiring an institution to develop and adopt effective, written lending procedures necessitates that the regulators review them for clarity, effectiveness and proof that the board of directors has adopted them. An agreement that the institution shall comply fully with new procedures requires a review for compliance with those procedures. This review should be in addition to the normal review for compliance with applicable regulations and safety and soundness.

Documentation

Throughout this handbook section, there is mention of the documentation required for taking supervisory and enforcement action. In general, prior to any formal investigation, regulatory staff is responsible for obtaining the documentation necessary to seek supervisory or enforcement action. In the event of a violation of a final order that may have to be enforced by bringing court action, the regulator should be particularly careful to determine if the noncompliance (or other conduct) is due to the association's administrative oversight, lack of knowledge or skill or willful disregard. In all cases, regional personnel should obtain clear documentary evidence of the violations or conduct. OTS enforcement attorneys will need that evidence in the event that OTS issues an order or if it must enforce the order in District Court. The regulator should summarize discussions with management in a written report, which should also include management's explanations of why such violations have occurred and the regulator's opinion as to the necessity of further enforcement action.

Termination or Modification of Enforcement Actions

Decisions to terminate or modify an enforcement action must be made in writing explaining the reasoning. An OTS examination documenting compliance with the enforcement action is a prerequisite to removal of the action.

CHAPTER: Examination Administration

SECTION: Trust and Asset Management Trust-Only Examinations

Section 090

Introduction

This section covers the procedures to be followed for the examination of OTS regulated savings associations and their holding companies when the savings association engages only in trust and asset management activities. These institutions are considered “special purpose” because they do not perform commercial or retail banking services by granting credit or taking deposits from the public in the ordinary course of business.

Criteria

Institutions meeting the trust and asset management activities only criteria do not engage in any lending activity, therefore they have, under OTS regulations, an exemption from the requirements of the Community Reinvestment Act (12 CFR §563e.11). Such institutions have minimal deposits, which leaves only assets to offset their relatively high capital ratios. These assets tend to be held in mortgage-backed securities. The unique nature of these institutions requires a specialized approach to their examinations.

Examination Procedures

The trust and asset management examination will be the lead examination for these institutions. In addition to following standard examination procedures, a review should be performed to ensure compliance with charter approval conditions.

A safety and soundness examination will be conducted concurrently with each trust and asset management examination. The examination schedule will be driven by the statutory examination requirement for safety and soundness examinations. The examiner-in-charge for the trust and asset management examination will share the findings and ratings for the *Management* and *Earnings* components with the examiner-in-charge of the safety and soundness examination. These two components will typically be identical for both trust and asset management and safety and soundness examinations. Because the trust and asset management activity is the only activity in which these institutions engage in, the CAMELS composite rating and the UITRS composite rating should always be the same.

The holding company directly controlling the savings association will have a concurrent examination. Standard holding company examination procedures will apply with emphasis on transactions with affiliates, revenue or tax sharing agreements and management.

Because these institutions are exempt from CRA and are not lenders, the compliance examination will consist of reviewing the savings association’s compliance with laws such as TILA, RESPA and Regulation Z when the institution takes certain actions on behalf of its trust accounts.